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Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

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Instruments for the Taxation of the Financial Sector

This report commits only the Commission's services involved in its preparation

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1. INTRODUCTION

This Impact Assessment (IA) analyzes different tax measures which share the objective to raise revenue from the activities of the financial sector so as to ensure the sector contributes further to the consolidation of European public finances. At the same time, some of the instruments are seen to generate a double dividend and create – next to revenues – positive behavioural incentives in order to reduce the probability of future financial crises. Section (2) describes the procedural steps taken in the framework of this IA and briefly summarizes the results of public consultations. Section (3) summarizes the state of play of the political debate and defines the problems which should be solved with the tax measures under scrutiny. Section (4) presents the resulting objectives and the baseline scenario which assumes that no action in the field of tax policy is taken. Section (5) describes the policy options under consideration. The impacts of each policy option are assessed in section (6) and evaluated in section (7).

Box (1). Definitions of the financial sector

The financial sector can be defined in several ways. In the public debate the focus is usually on (large) banks. However, the financial sector is much more widely defined in the European Sectoral Accounts where it includes financial intermediation, insurance and auxiliary financial services. This Eurostat-Definition of the financial sector is used for the discussion of the Financial Activities Tax (FAT).

In the case of a Financial Transactions Tax (FTT) or one of its subsets the definition is wider since all market participants which conduct certain financial transactions (including retail investors and professional traders as well as in theory non-financial companies and households) are taxed.

In the case of bank levies (see Annex 2 for a detailed description of the concept) the definition is narrow and focuses on credit institutions. Bank levies are briefly discussed in this document in the context of the cumulative effect of taxation and regulation. Bank levies which have been implemented recently in Member States are either used to finance some national resolution scheme or to finance the general budget.

2. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

An Inter-service Steering Group on Financial Sector Taxation was set up in December 2010 comprising the following Directorate-Generals: TAXUD (Lead), BUDG, ECFIN, EMPL, LS, MARKT and SG. The Steering Group met on 6 January, 18 February, 6 May and 9 June 2011. Comments raised by other services during the last meeting of the Steering Group have all been integrated into the version which was send for evaluation by the Impact Assessment Board (IAB).

The Impact Assessment was presented to IAB on 13 July. The IAB accepted the Impact Assessment subject to the revision of the report following the Board's suggestions. In its opinion, the IAB proposed the following improvements to the document. Firstly, the IAB suggested that the report should better integrate the most relevant results of the analysis of expected impacts contained in the annexes into the main text, including greater transparency on the modelling assumptions and on the robustness of modelling results. In response, the report was adapted accordingly. Results and assumptions of models and estimates have been added to the main text in sections 7.8.4 and in explanatory footnotes.

Secondly, the IAB noted that the baseline scenario should be strengthened by better taking account of current Member State actions and problems resulting from non-harmonised and

possibly overlapping regulations. In addition, the Board asked for a more detailed analysis of subsidiarity. To implement the suggestion, additional explanations covering these aspects have been added in section 3.1 and 3.2.

Thirdly, the report should give a clearer overview of the expected impacts of the two main options on the real economy as well as the EU financial sector, including on growth and competitiveness. Following this proposal, the main text has been modified to give a clearer view about the potential effects in particular in sections 7.8.

2.1. External consultation and expertise

2.1.1. External studies

The Commission has launched in total three studies in the context of this IA. One study has been contracted to PricewaterhouseCoopers (PwC). This study analyses four areas of the tax system in order to identify potential legal provisions which might lead to tax advantages or disadvantages for the financial sector. The taxes considered are the Corporate Income Tax (CIT), the Personal Income Tax (PIT), the Value-added Tax (VAT) and the tax treatment of financial products. The details of the study are presented in Annex 3.

A study on the reaction of profits and transactions to tax increases was commissioned to Copenhagen Economics. The study reviews the existing empirical literature with regards to the tax elasticities of profits, remuneration and transaction volumes in different markets. The details of the study are presented in Annex 9.

The third study on remuneration in the financial sector was commissioned to the 'Chair of Applied Economics: Innovation and Internationalization' at the ETH Zürich. The study provides an assessment of the extent of managerial pay around the world. It uses a novel database on managerial wages and other forms of compensation to compare managerial remuneration across different sectors with a special emphasis on the financial sector versus other sectors, and it does so by comparing different countries with each other for the years 2002 to 2007. The detailed study can be found in Annex 4.

2.1.2. Public consultation

The public consultation[1], launched on 22 February 2011 and closed on 19 April 2011, aimed at receiving stakeholders' feedback on this topic and in particular:

(a) to test assumptions and collect evidence as regards the definition of the problems;

(b) to assess the impacts of the set of policy options; and

(c) to consult on more detailed aspects of the feasibility and design of the policy options.

2.1.3. Submissions by stakeholders group

Table (1). Feedback from stakeholder groups

Registered financial organisations	**45**

1 http://ec.europa.eu/taxation_customs/common/consultations/tax/2011_02_financial_sector_taxation_en.htm

Registered non-financial organisations	**45**
Non-registered financial organisations	**22**
Non-registered non-financial organisations	**63**
Public authorities	**17**
Citizens	
Individual submissions	**21**
Petitions	**3411**[2]
Total individual submissions	**213**
Total submissions (including petitions)	**3624**

The public consultation generated considerable interest. More than 200 individual replies as well as a large number of petitions were received. All individual responses to this public consultation have been published[3]. A detailed analysis of the responses is included in Annex 1. The feedback was divided into six stakeholder groups listed below with the corresponding number of inputs[4]. Table (1) gives an overview of the stakeholders.

2.1.4. Positions of stakeholders in general

Common points

In general, opinions of the respondents to the public consultation mentioned above are strongly polarised depending on the groups and subgroups to which they belong. Nevertheless, it must be pointed out that there is a general agreement among the vast majority of respondents that patchwork measures introduced by Member States pose a problem, which is most often linked to possible distortions in the functioning of the internal market (including relocation and double taxation) and the level playing field in the EU. Another point of agreement amongst respondents is that improper risk management, improper incentive schemes, extensive deregulation and lax supervision were amongst the reasons for the financial crisis.

Financial organisations, business and consultancies

Registered financial organisations, non-registered financial organisations and the business, accounting/consulting and real estate subgroups generally oppose any additional tax burden on the financial sector or financial markets in general.

NGOs and trade unions

NGOs and trade unions (registered and non-registered) appear strongly in favour of a broad-based financial transactions tax (FTT) levied at EU level (with some submissions accepting it at Eurozone level). NGOs are by and large neutral vis-à-vis a financial activities tax (FAT) as long as it does not "crowd-out" the FTT implementation. Some trade unions are against an FAT, mainly because they view it as a tax on labour.

Authorities

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2 There are claims that many more such e-mails have been sent.

3 http://circa.europa.eu/Public/irc/taxud/consultation_taxation/library

4 A large number of contributions were not filed in the correct dedicated email and had to be assigned to the respective stakeholder group at the processing stage under certain assumptions. Stakeholder subgroups are detailed in Annex 1.

Public authorities, Central Banks and one Member State are clearly against both FTT and FAT. Two other Member States would accept a FTT globally, while one of them would accept it at EU level in the form of a currency transaction tax (CTT). The fourth Member State also opposes an EU-wide solution, and shows a slight preference towards a rent-taxing FAT for the global level. Local authorities (mostly representatives in the Committee of Regions) accept a broad-based FTT at EU level.

Citizens

Citizens' individual submissions and the very large number of petitions are generally in favour of a broad-based FTT.

2.1.5. Consultations with stakeholders and Member States

2.1.5.1. Focused consultation workshop

On 4 May 2011 a focused consultation workshop with representatives of the relevant associations of financial market operators[5] took place in DG TAXUD's premises. The agenda of the workshops included a preliminary summary by TAXUD of the results of the public consultation, a round-table on industry's assessment of expected administrative costs related to FTT and FAT and a number of technical issues, including those covered by the public consultation questionnaire. The arguments raised by the representatives were following closely their individual contributions to the public consultation outlined above. A summary of the discussions at the focused consultation workshop is included in Annex 1.

2.1.5.2. Consultations with Member States

In addition, the potential instruments for an additional taxation of the financial sector were twice on the agenda of the Tax Policy Group chaired by Commissioner Šemeta. These discussions took place in October 2010 and in January 2011 and showed diversity in the opinions of Member States on this issue. In addition, Member States and the Commission discussed the issue of financial sector taxation in the Council High Level Working Party on 8 December 2010 and on 28 April 2011.

2.1.5.3. Consultations with academia and practitioners

The Brussels Tax Forum[6] of 28-29 March 2011 was dedicated to "Taxation of the Financial Sector". The audience and the speakers and panellists included a large number of academics, tax practitioners, policy-makers and other stakeholders. The main topics discussed were the responsibility of the financial sector in the crisis and the public support for the financial sector, the under/over taxation of the financial sector, the interactions with initiatives in the area of financial regulation, and the options for taxing the financial sector – FTT and FAT. A summary of the discussions is included in Annex 1.

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5 European Association of Cooperative Banks, European Savings Bank Group, European Banking Federation, European Association of Public Banks, Association of International Life Offices, Comité Européen des Assurances, Association of European Cooperative and Mutual Insurers, Association Internationale des Sociétés d'Assurance Mutuelle, European Fund and Asset Management Association, Alternative Investment Management Association, The European Forum of Securities Association, European Central Securities Depositories Association, International Capital Market Association, Federation of European Securities Exchanges.

6 http://ec.europa.eu/taxation_customs/taxation/gen_info/tax_conferences/tax_forum/index_en.htm

On 11 May, the Commission held a by-invitation workshop with academics from different fields in its premises as to get technical inputs on some of the issues raised in the impact assessment, among which the presentations of the General Equilibrium Models and the SYMBOL model, the risks of relocation, the clarification of some technical concepts and the interactions between taxation and regulation.

2.1.5.4. Consultation with social partners

1. Liaison forum

On 7 March 2011 the issue of the taxation of the financial sector and the upcoming impact assessment was presented by DG TAXUD at the Liaison forum.

Trade union representatives expressed some concern that the burden of FAT would fall on labour and hence employment in the sector. TAXUD clarified that the tax base of any form of FAT is much broader than just wages (i.e. profit besides remuneration), that (marginal) employment decisions would in principle not be impacted by the tax since the addition-method FAT base is insensitive to labour costs (as since the base is the sum of profit and remunerations and remunerations is a deductible cost on the profit part, any change in labour costs is matched by an equivalent change in the profit part of the base). The rent taxing and risk taxing versions of FAT would fall on excessive remuneration only.

2. Meeting with UNI-Europa

On 3 May 2011, TAXUD participated in a meeting with trade union representatives, on which the same concerns about the impact of a FAT on employment in the sector were voiced.

3. POLICY CONTEXT, PROBLEM DEFINITION AND EU RIGHT TO ACT

The debate on new taxes targeted to the financial sector or the activities in financial markets has gained momentum after the recent financial and economic crisis. The discussion currently focuses on two policy goals. Firstly, the generation of additional tax revenue. Secondly, the use of taxes as a tool to improve the functioning of financial markets in general. In order to frame the debate, it is useful to briefly recall the roots of the crisis. It allows better identifying the regulatory aspects at stake and the political motivation to raise taxes on the financial sector.

Ample liquidity and low interest rates have been major underlying factors behind the crisis. Financial innovation – including the development of structured products - amplified and accelerated the consequences of excess liquidity and rapid credit expansion.[7] In an environment of plentiful liquidity, historically low interest rates and low returns, investors actively sought opportunities for higher yields. Risk became largely mispriced. Thus, an increased number of innovative and complex instruments were designed to offer such high yields, often combined with an increased leverage. In particular, financial institutions securitized their loans into mortgage- or asset-backed securities, subsequently turned into collateralised obligations, generating a dramatic expansion of leverage within the financial

[7] More detailed analyses of the roots of the crisis can be found in BIS (2010a), FSA (2009), Hemmelgarn, Nicodeme and Zangari (2011) and Hemmelgarn and Nicodème (2010) as well as in the de Larosière Report (2009).

system as a whole.[8] Financial institutions engaged in very high leverage ratio of beyond 30 – sometimes as high as 60 – making them exceedingly vulnerable to even a modest fall in asset values. When the assets value fell rapidly, the resulting losses could not be absorbed by common equity, leading to serious solvency and liquidity problems and thereby putting the ailing institution, its counterparties and eventually the whole financial system at risk.

Failures in risk assessment and management were aggravated by the fact that remuneration and incentive schemes within the financial institutions contributed to excessive risk-taking by rewarding short-term expansion of the volume of (risky) traders rather than the long-term profitability of investment.[9] These pressures were not contained by regulatory or supervisory policy or practise and regulation was not effective in mitigating these risks. For instance, capital requirements were particularly light on proprietary trading transactions while (as events showed later) the risks involved in these transactions proved to be much higher than the internal models had expected.

During the crisis, many governments – both at global level and within the EU – realized that, in contrast to many other sectors of the economy, allowing individual banks and other systemic financial institutions to fail may have been detrimental to the whole economy. There was no simple way for a (systemically important) bank to continue to provide essential banking functions whilst in insolvency, and in the case of a failure of a large bank, those functions could not be simply shut down without significant systemic damage. The actions that governments were forced to take to deal with banking institutions in distress – capital injections, guarantees and loans – have stabilised the financial system. However, they also propped up failing institutions and supported creditors at huge costs to public finances.[10]

Although taxes have not been among the primary causes for the crisis, they may have aggravated it, insofar as they have had the potential to exacerbate behaviours that may have contributed to the crisis. Tax rules encouraging excessive debt, complex financial transactions, poorly designed incentive compensation for corporate managers and highly leveraged home-ownership all may have contributed to the crisis.[11]

In October 2009, the European Council agreed that a coordinated strategy for exiting stimulus policies was needed for when the recovery was secured and invited the Commission to examine innovative financing at a global level. This first analysis provided by the Commission Services (European Commission, 2010d) suggested that some instruments, notably levies on financial companies based on balance sheet items, could bring a *"significant "double dividend" of both raising revenues and improving market efficiency and stability."*

In March 2010, the European Parliament adopted a resolution calling the Commission to carry out an assessment on a Financial Transactions Tax (FTT). The Parliament also recommended the use of innovative finance instruments in the context of a report on the impact of the financial and economic crisis on developing countries.

In parallel, an international debate started at the G-20 level where leaders asked the IMF to: *"...prepare a report for our next meeting [June 2010] with regard to the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burden associated with government*

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8 See de Larosière Report (2009).

9 Idem.

10 See section 3.1.1 for detailed figures.

11 See Shaviro (2011) and Ceriani et al. (2011).

interventions to repair the banking system." The IMF (2010a) report proposes two possible forms of contribution from the financial sector, serving distinct purposes (a) a "*Financial Stability Contribution"* (FSC) linked to a credible and effective resolution mechanism and, if additional revenues are needed for consolidation purposes, (b) a "*Financial Activities Tax"* (FAT) levied on the sum of the profits and remuneration of financial institutions. The IMF did not propose the FTT as a tax instrument arguing that there are important drawbacks when seen as a corrective tool to improve financial market performance and would not "*appear well suited to the specific purposes set out in the mandate from G-20 leaders.*" The argumentation of the IMF was based on its strict mandate of finding instruments that make the financial sector pay for public interventions. In this context, the IMF considered that the measures shall (i) ensure that the financial sector meets the direct fiscal cost of any future support; (ii) make failures less likely and less damaging, most importantly by facilitating an effective resolution scheme; (iii) be reasonably easy to implement, including in the degree of international coordination required; (iv) enable, to the extent desired, an additional fiscal contribution from the financial sector to recognize that the costs to countries of crises exceed the fiscal cost of direct support; and (v) address existing tax distortions at odds with financial stability concerns and ensure a reasonable overall burden of regulation and taxation. The IMF concluded that the FTT does not appear well-suited for the purposes of the G20 because: (a) It is not the best way to finance a resolution mechanism as the volume of financial transactions is a poor proxy for the benefits conveyed by a resolution fund to specific institutions or for the costs of intervention from public sector; (b) A FTT does not focus on the core sources of instability (size of institutions, interconnectivity, and substitutability, which give rise to systemic risk); (c) The FTT has a cumulative and cascading effect which may largely fall on final consumers rather than financial institutions; (d) a FTT taxes transactions between businesses. The argument that a FTT would cause little distortions because it would be levied at a very low rate on a very broad base is not persuasive. By distorting business decisions, a FTT reduces total output because it cascades into all prices at each stage of the production. In total, it raises less revenue than if applied to the final stage only (this is similar to the reason why VAT is superior to a sales tax); and (e) It is vulnerable to avoidance by engineering. A consequence of cascading would be avoidance by integration, leading to larger financial institutions. Finally, the IMF (2010a, page 18) also states that its corrective attribute have significant drawbacks: (i) it is far from clear what an ideal ratio of 'productive' to 'non-productive' financial activities would be, (ii) it is difficult to distinguish 'desirable' and 'undesirable' transactions or to assess their importance and higher transaction costs do not necessarily prevent bubbles, as seen in the housing market, (iii) both in theory and in practice, an FTT does not necessarily reduce volatility; (iv) an FTT would increase the cost of capital for all firms issuing tax securities;

After an initial examination, the European Commission (2010e, 2010f) put forward a twofold approach in October 2010. The Commission supported further exploration and development of a Financial Transactions Tax (FTT) at the global level and wanted to promote an agreement with the most relevant partners. At EU-level, the Commission saw potential in a Financial Activities Tax (FAT). In the light of these conclusions, the Commission announced in its October 2010 communication to "*launch a comprehensive impact assessment, which will further examine each of these options, in order to be in a position to make appropriate proposals on policy actions by summer 2011."* The present document is the result of this additional analysis.

The European Council on 28 and 29 October 2010 considered that the Commission should pursue its assessment taking into account the cumulative impact of regulatory and taxation measures on the financial sector, the need to avoid double taxation and to maintain a level

playing field as well as the role that levies should play in a credible crisis management framework. At the European Council meeting on 11 March 2011 the heads of state or government of the Euro area agreed that *"the introduction of a financial transaction tax should be explored and developed further at the Euro area, EU and international levels."* At the European Council meeting on 24 and 25 March 2011 the heads of state and government concluded that *"as agreed by the European Council in June 2010, the introduction of a global financial transaction tax should be explored and developed further. The European Council notes the intention of the Commission to make a report on taxation of the financial sector by autumn 2011 at the latest."* The debate was also part of the EU Budget Review of October 2010 which states that *"The Commission considers that the following non-exclusive list of financing means could be possible candidates for own resources to gradually displace national contributions, leaving a lesser burden on national treasuries: - EU taxation of the financial sector."*

On 8 March 2011 the European Parliament adopted a resolution on "Innovative financing at global and European level" which contains the following statements: *(The EP) "stresses that an FAT is mainly a revenue-oriented tax tool that targets the financial sector, making it possible to tax economic rents and profits from excessive risk-taking, and as such could provide a solution to the current VAT exemption of the financial sector", "Favours the introduction of a tax on financial transactions, …; considers that the introduction of a tax on financial transactions ought to be as broadly based as possible and that the EU should promote the introduction of an FTT at global level; failing that, the EU should implement an FTT at European level as a first step."* The resolution also *"calls on the Commission and the Council to assess the potential of different financial transaction tax options to contribute to the EU budget."*

On 29th June 2011, the European Commission put forward a proposal for the Multiannual Financial Framework 2014-2020. In this context, the European Commission proposes new own resources to decrease national contributions and thus contribute to budgetary consolidation efforts in the Member States; to create a link between EU policy objectives and the EU financing; and to make the system more transparent and fairer. This proposal includes a Financial Transactions Tax at the EU-level. The rationale is that it *'would give extra room for manoeuvre to national governments and contribute to general budgetary consolidation efforts. Such taxation exists at national level in some Member States, but action at EU level could prove more effective and efficient, and it could play a role in reducing the existing fragmentation of the Internal Market.*'[12]

In parallel to the debate on new taxes, a comprehensive regulatory reform is still ongoing in order to improve the stability of the financial system. These reforms comprise tighter rules on capital requirements, better incentives in compensation systems, an increase in the use of central clearing platforms (CCP), better supervision and regulation and market transparency among others. All these elements (see Annex 2) shall be included in the analysis as to assess the cumulative impact of potential tax measures with upcoming regulatory changes.

[12] Multiannual Financial Framework (MFF): Questions and answers. MEMO/11/468.

3.1. Problem definition

3.1.1. Costs of the crisis

The fact that allowing banks and other systemic financial institutions to fail may become detrimental to the economy, forced many Member States to quickly implement a number of ad-hoc measures to avoid the collapse of the financial system and to alleviate the economic consequences of the crisis on the nonfinancial sector. The crisis response took the form of specific measures aimed at banks and measures to stimulate the economy so as to offset the short-term negative demand effects of plummeting business and consumer confidence. In the European Union, Member States individually committed to recapitalization of their financial institutions, guarantees on bank liabilities, relief of impaired assets and liquidity and bank funding support for a total representing about EUR 4.6 trillion (39% of EU-27 GDP in 2009), while the amount actually used in 2008 and 2009 is around EUR 2.3 trillion.[13]

Moreover, the economic crisis that was triggered by the financial crisis aggravated further the stance of public finances in Member States, partly due to rescue packages for the financial sector and the bursting of real-estate bubbles. Consequently, EU-27 average public deficits increased from 0.9% of GDP in 2007 to 6.4% in 2010 and public debt jumped from below 60% of GDP in 2007 to above 80% for the years to come (European Commission, 2011 Spring Economic Forecast). Budgetary commitments in this range are not sustainable from a fiscal point of view, and impose heavy burden on the present and future generations.[14] There is an urgent need to improve the quality of public finances on a lasting basis, both on the expenditure and revenue sides. Higher tax revenues as well as higher user fees and charges would have to be considered in this context, including higher taxes on the financial sector.

3.1.2. VAT exemption of financial services

The EU's common value added tax system has generally exempted mainstream financial services including insurances and investment funds. Article 135(1) of the VAT Directive provides an exemption from VAT for most financial and insurance services.[15]

To some extent, the Directive reflects an uncertain approach in that it also allows EU Member States the option of taxing financial services. The difficulty is, however, to technically define the price for specific financial operations. Around two-thirds of all financial services are margin based which makes the implementation of the invoice-credit VAT system very difficult in this respect.[16] In practice however this difficulty seems to be surmountable – for instance in Germany when the granting of loans is subject to VAT under the option to tax, an acceptable methodology seems to have been found to tax these margin-based operations.[17]

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13 See European Commission State Aid Scoreboard – Autumn 2010 update (Chapter 3): http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2010:1462:FIN:EN:PDF

14 The IMF (2010b) has projected that the cost of government debt in advanced G-20 economies will rise by almost 40 percentage points between 2008 and 2015

15 Commission proposals for a Directive COM(2007)747 and a Regulation COM(2007)746 as regards the VAT treatment of insurance and financial services aim at modernising and simplifying the current complex VAT rules for financial and insurance services and securing a level playing field in the pan-EU market for these services as far as VAT is concerned. See also Annex 17.

16 The problem of VAT on financial services is described in more detail in Kerrigan (2008) as well as in Mirrlees et al. (2010), chapter 8.

17 Another theoretical possibility would be the application of a transaction-based VAT as presented by Poddar and English (1997), known as the "Truncated Cash-Flow Method with Tax Calculation

The extent to which applying VAT to the financial sector (and its clients) would raise additional tax revenues and – consequently – the extent to which the exemption constitutes a tax advantage for the financial sector is an unsettled empirical question. Whereas the exemption means that the financial sector does not charge VAT on most of its output, it cannot deduct the VAT charged on its inputs. This is known as the 'irrecoverable VAT problem'. While estimates by Genser and Winker (1997) for Germany (7 billion DM for 1994), Huizinga (2002) for the EU-15 (12 billion EUR for 1998 or 0.15% of GDP) and the UK Treasury (2011) for the UK (£ 9.05 billion or about 0.6% of GDP)[18] suggest that there might be a sizeable tax advantage (measured as VAT not collected), arguments are also put forward that claim that irrecoverable VAT is the largest tax burden for the sector.

Annex 5 presents a new estimate of the magnitude of the problem. The calculations are based on European Sector Accounts on the consumption of financial services by sectors. Note however, that the data are restricted to financial intermediation. Other tax exempt financial services are not covered. The results of the estimation are presented in table (2). The data are used to estimate the potential advantage from VAT exemption by applying methodologies proposed by Huizinga (2002) and de la Feria and Lockwood (2010). Three estimations are presented below. The difference between them is the data basis for the calculation of the irrecoverable VAT which in case of a VAT application would be fully deductible.

Table (2). VAT exemption of the financial sector: Potential tax advantage

	Estimation (1)		Estimation (2)		Estimation (3)	
Year	bn. EUR	% of GDP	bn. EUR	% of GDP	bn. EUR	% of GDP
2000	13.7	0.15	16.3	0.18	14.2	0.15
2001	14.1	0.15	16.9	0.18	14.9	0.16
2002	15.2	0.15	19.0	0.19	17.2	0.17
2003	17.2	0.17	20.5	0.20	19.1	0.19
2004	18.3	0.17	21.7	0.20	20.1	0.19
2005	17.6	0.16	21.5	0.19	20.0	0.18
2006	14.4	0.12	21.9	0.19	20.2	0.17
2007	13.7	0.11	23.0	0.19	21.5	0.17
2008	14.1	0.11	22.6	0.18	21.0	0.17
2009*	18.1	0.15	25.3	0.21	23.6	0.20

*Note that no data is available for the UK for 2009 in estimations 2 and 3. Therefore, the 2008 value for the UK has been used to calculate EU figures for 2009. See Annex 5 for details.

The most reliable data is the one from estimation (1) where the intermediate consumption of the financial intermediation can be directly measured using the Input-Output tables. The data suggest that the VAT exemption leads to an advantage in the range of 0.11% and 0.17% of GDP. This is in line with the results of Huizinga (2002) of around 0.15% of GDP mentioned above. It should be stressed that all these estimates are very rough approximations and should be interpreted with caution. However, they indicate that the argument that the VAT exemption of financial services might be an advantage for the financial sector has some merits. The results do not change significantly when other estimates for the irrecoverable VAT based on sector account data are used.

Account". Such alternative approaches have been considered in European Commission (1996) and Ernst and Young (1996).

[18] http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.pdf . UK GDP is estimated at £ 1,453 billion (table A2 in http://www.statistics.gov.uk/pdfdir/oie0511.pdf)

Note that all three estimates do not take into account the behavioural response due to price changes when applying VAT to financial services. The inclusion of the financial sector in the VAT would indeed lead to price changes, but such changes should be seen as the correction of an existing distortion rather than as a new distortion. The reason is that next to the question of whether VAT on financial services would raise revenues, there is an economic distortion arising from the current VAT exemption. While services provided to households are too cheap, services to businesses are more expensive. This leads to a misallocation of the consumption of financial services.

In summary, the VAT exemption for a large share of financial services is an important issue. It possibly results in a preferential treatment of the financial sector compared with other sectors of the economy as well as in distortions of prices.

3.1.3. Market failure and systemic risks in the financial sector

As explained above, the crisis resulted from the complex interaction of market failures, global financial and monetary imbalances, inappropriate regulation, weak supervision and poor macro-prudential oversight. As a reaction to these deficiencies, numerous regulatory reforms have already been implemented or are currently under consideration (see also the baseline scenario, table 4 and Annex 2). Financial sector taxes could be part of the toolbox for regulatory reform and flank some regulatory goals, notably reducing leverage or short-term speculation while also generating tax revenue.

Taxation as a tool to internalize externalities or to correct certain incentives is not linked to the generation of revenue – even though many assume that taxes could indeed generate a 'double dividend' by raising revenue and creating positive behavioural incentives. The basic idea is that taxes could improve financial sector stability and the functioning of the market. For example, trading activity in financial markets is often criticised as leading to inefficiencies, excessive liquidity and asset price bubbles. The revision of the Directive on the Markets of Financial Instruments (MIFID) regulates new trading technologies and address related risks of disorderly trading. In addition, a tax on financial transactions would make high frequency trading less profitable.

(1) Undesirable market behaviour due to implicit guarantees (systemic risks)

The fact that the financial sector differs in many respects from other sectors has put it in a position to benefit from incentives which might be harmful for the economy as a whole. Notably, allowing banks and other systemic financial institutions to fail may become detrimental to the economy, forcing governments to bail-out systemically relevant institutes. The existence of an (implicit or explicit) safety net combined with banking regulation may be an incentive for such institutions to engage in higher risk taking, since the profits from these activities can be privatised while losses will be socialised. It should be noted that this mechanism is not necessarily limited to the financial sector but can also occur in other industries with create negative externalities to the rest of the economy. It should also be noted that some losses have also been borne by shareholders of banks[19].

[19] In Annex 14, we use the SYMBOL model to assess the probability and magnitude of systemic losses deriving from banks' defaults as well as individual contributions of banks to systemic risk under both scenarios of contagion of bank losses and no contagion. Adrian and Brunnermeier (2010) define systemic risk as CoVaR, the value at risk (VaR) of the financial system conditional on institutions being under distress. With this measure, the contribution of an individual institution to systemic risk is the

In summary, the underlying driver is that implicit state guarantees for financial sector institutions are not considered when risks are mispriced in markets which could create the problem incentives to engage in risky investments. Profits can be privatized while losses are socialized. The initiatives discussed in this report will not address this problem.

(2) Automated trading (high frequency trading)

While the empirical economic literature is still rather inconclusive on effects from this trading form in terms of increased volatility or price deviations,[20] regulators as well as policy makers point to the risks that this algorithmic or automated trading may trigger.[21]

This potential specific risk will be addressed in the Revision of the Directive on the Markets of Financial Instruments (MIFID). The policy option chosen there is part of the baseline scenario in this Impact Assessment which is part of the baseline scenario.

Automated trading (and more generally short-term speculation) is seen by some as source of volatility and asset price bubbles due to self-enforcing trends.[22]

(3) Distortions of debt-equity choice: Leverage

The tax deductibility of interest payments in most corporate income tax systems coupled with no such measure for equity financing creates at least two types of tax distortions. First, it may influence financing decisions and lead to too-high leverage. Second, this distortion in financing exacerbates opportunities to shift and decrease reported profit via debt-shifting or the use of hybrid instruments. These problems are well-known (see Annex 18).

In the context of the crisis, the debt-equity distortions did not create the financial crisis but it leaned in the wrong direction and may have aggravated it.[23] High leverage could lead to liquidity constraints, especially in times when banks tend to restrict their credit supply.

It shall be stressed that the problem of tax induced leverage can be tackled by removing the preferential treatment of debt in the current CIT system of most Member States. Several immediate solutions are discussed in Annex 18.

In summary, the different tax treatment of debt and equity could distort financing decisions and increase leverage and incentives to engage in risky investments.

(4) Excessive executive compensation schemes encourage risk-taking

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difference between CoVaR conditional on the institution being under distress and the CoVaR in the median state of the institution. They show that leverage (alongside relative size and maturity mismatch) exerts an effect on systemic risk.

[20] Chaboud, A., B. Chiquoine, E. Hjalmarsson und C. Vega (2009) analyse the effects of this trading form in the context of FX markets. Some recent research has pointed to the fact that high-frequency trading may create information rents for traders using these tools (Biais and Woolley, 2011) and could increase volatility (Dichev, Huang and Zhou, 2011). See The Economist (2011) for a discussion.

[21] For example the ECB pointed to potential issues in a reply to a public consultation. The document can be accessed online at: http://www.ecb.int/pub/pdf/other/ecpublicconsultationreviewmifideurosystemcontribution201102en.pdf

[22] See Schulmeister (2011).

[23] See Shaviro (2011), Shackelford, Shaviro and Slemrod (2011), IMF (2010a), (2010b) and Hemmelgarn and Nicodème (2010) for a discussion.

Since the 1980s and notably over the last two decades there is a tendency for companies to develop specific executive compensation schemes, such as bonus payments and notably stock option plans. The strong increase in executive compensation over the last two decades in the economy as a whole can be largely attributed to the latter instrument.

Excessive remuneration schemes, keyed to short-term returns and business volume, might be an incentive to increase leverage and to engage in risky investment, as profits will be privatised while losses remain in the company or will be socialised via a bail-out through the state. Therefore, managers might favour short-term risky investment to increase their remuneration.[24]

Furthermore, in several countries stock option schemes benefit from favourable tax treatment such as deductibility from the corporate income tax combined with exemption from personal income tax or social security contribution[25]. Such favourable tax treatment may have led managers to prefer to receive their remuneration in the form of stock options instead of traditional wages and to focus on short-term measures to increase the value of their stocks. This may have increased corporate short-term risk-taking and contributed to speculative bubbles. Reducing the potential payouts via taxation, notably with a FAT, might reduce these incentives.

In summary, excessive remuneration schemes and incentive compensation for managers could lead to higher engagement in risky investments.

(5) Complex products and counterparty risk

Large amounts of complex derivatives are viewed as being one reason for the crisis. They enable companies to place leverage, hedge and speculate cheaply, while hindering investor and supervisory oversight of risks involved and created webs of counterparty risk that ended up transmitting credit problems across the world economy.

Derivatives permit taxpayers to increase the degree of separation between the economic fundamentals of their positions and the tax systems interpretation of what they are doing.[26] Derivatives create three main types of problems for the tax system. The first is the asymmetry in the treatment of counterparties, as in the case where a periodic time-value return can be deducted on one side without being included on the other. The second is the inconsistency in the treatment of a given economic arrangement (e.g. total return swap leads to economically owing a particular stock without being treated as the owner for tax purposes). The third is the imbalance in the treatment of gains and losses, as in the case where one can immediately realise the loss whereas a gain would be deferred indefinitely or taxed at less than the ordinary income rate (a technique known as straddle).

The excessive use of complex products can create uncertainty and information asymmetries in markets. The initiatives discussed in this report will not address this problem.

(6) Economic rents

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24 See Ceriani et al. (2011) and OECD (2009).

25 See Annex 3 and OECD (2006).

26 See for example Shaviro (2011), p.16.

The debate on a "fair and substantial" contribution of the financial sector to the revenue cannot be disconnected from the issue of profitability of the sector. There is some evidence that the financial sector has been more profitable than the non-financial sector over the last two decades[27]. This is not as such problematic if this above-normal profit is related to high productivity. However, the high profitability of the sector could also result from the existence of an (implicit or explicit) safety net, combined with banking regulation or the VAT exemption. The special regulatory framework under which some parts of the financial sector operate might allow the creation of economic rents which are not reduced over time by competitive pressures. In this case the financial sector could indeed make a more substantial contribution to government finances by the introduction of new taxes which are directed at economic rents and/ or which take into account the VAT exemption of most financial services.[28]

The data used in this IA on individual companies active in the financial sector suggests however that profitability is very heterogeneous within the sector and depends on the segment of activity as well as on the size of the company measured as total assets but in a non-linear manner. This heterogeneity within the financial sector can also be found when analysing the structure of executive compensation of the financial sector. Annex 4 shows empirically that there is a significant earnings premium in the financial sector which amounts for the overall sample available (including both EU and Non-EU countries) to about 40% after conditioning out observable director-specific and firm-specific characteristics. Yet, there is considerable heterogeneity of earnings across different types of businesses within the financial sector. In fact, one should expect that compensation levels differ sharply between more conservative commercial banks and riskier investment companies. Using the conservative commercial banking remuneration as a reference point, the study in Annex 4 shows that individuals in the real estate sector, the insurance sector and the set of other financial business earn significantly higher compensation compared to commercial banking. This holds for the whole sample as well as for the EU-subsample.

For the US, Philippon and Reshef (2009) identify the existence of economic rents in the financial sector which can explain 30 percent to 50 percent of the wage differential. The authors use detailed data on wages in the US financial sector between 1930 and 2006 to provide evidence that these reached excessively high levels especially around 1930 and between 1995 and 2006. Their results suggest that on the one hand, complex corporate activities such as Initial Public Offerings (IPO) or credit risk have a positive effect on the demand for skilled workers whereas on the other hand, stricter regulation has a negative effect on the demand for skilled workers.

3.1.4. Internal Market aspects

Sweden introduced a 50 basis points tax on the purchase or sale of equity securities in January 1984. A round trip transaction (purchase and sale) resulted therefore in a 100 basis points tax. The tax applied to all equity security trades in Sweden using local brokerage services as well as to stock options. The fact that only local brokerage services were taxed is in the literature

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27 See Devereux et al. (2004) and Lepetit (2010) p. 19.

28 In addition to this, recent empirical work by Arcand et al. (2011) poses the question whether the size of the financial sector might be too big and whether there is therefore too much finance measured in terms of credit to the private sector in terms of GDP. The study confirms the positive effect of additional finance at intermediate levels of finance, but finds that the marginal effect of financial development on output growth becomes negative when credit to private sector surpasses 110% of GDP.

seen as the main design problem of the Swedish system. In July 1986, the tax rate was increased to 100 basis points. In 1987, the tax base was extended and half the normal rate was also applied to transactions between dealers. In January 1989, a tax on fixed-income securities was introduced. The tax rate was 0.2 basis points for a security with a maturity of 90 days or less. On a bond with a maturity of five years or more, the tax was three basis points. Only 15 months later, on 15 April 1990, the tax on fixed-income securities was abolished. In January 1991 the rates on the remaining taxes were cut by half and by the end of the year, they were also abolished completely.

There are different reasons for the abolition of the tax. First of all, the revenues from the taxes were disappointing due to ample possibilities for tax avoidance. The revenues from the tax on fixed-income securities were expected to amount to 1,500 million Swedish kroner per year, but the average was only around 50 million a year. Furthermore, since trading volumes fell, the capital gains tax became less and less applicable and revenue declined. The increase in revenue from equity transaction taxes was almost entirely offset by this reduction in capital gains taxes. The net budget effect was accordingly close to zero. An additional reason for the decline in revenue from capital gains taxes was the decline in share prices that accompanied the introduction of the transaction tax. These declines were in line with the net present value of tax payments on future trades. Investors discounted the future payments and prices for equity decreased driving up capital costs accordingly.

Next to the low revenue generated from the tax, relocation became a serious problem in Sweden. 60% of the trading volume of the eleven most actively traded Swedish share classes moved to the UK after the announcement in 1986 that the tax rate would double. 30% of all Swedish equity trading moved offshore. By 1990, more than 50% of all Swedish trading had moved to London. Foreign investors reacted to the tax by moving their trading offshore while domestic investors reacted by reducing the number of their equity trades.

The Swedish example shows that the financial sector has a very high mobility which makes it difficult for Member States to act unilaterally. Furthermore, the sensitivity with regard to the slightest changes in the tax rate indicates that not only the tax base is of importance but also the applied rates. Uncoordinated national measures might therefore lead to the problem of relocation and distortion of competition. When the tax base covers a wide range of financial products an international coordination is highly advisable.

The Internal Market and revenue raising are linked because the implementation of national (and to some extent also EU-wide taxes) raises questions of co-ordination in order to guarantee that additional frictions in the functioning of the market and tax arbitrage are minimized and that the competitiveness of the EU as a whole compared to other global players is preserved or ideally even improved. The introduction of country specific systems of new taxes could lead to distortions and result in double charging of financial institutions that are active cross-border in the internal market. A specific example of potential double taxation is described in section 5.2.6.

3.1.5. Baseline scenario

The baseline scenario describes the state of the world without introducing new tax measures on the financial sector. In the framework of this IA the baseline scenario has a special weight. The reason is that many of the problems defined in section 3.1.3 are addressed by regulatory reforms. Table (4) in section 5.1 gives an overview of the objectives and the connection with regulatory reforms.

3.1.5.1. Current Taxation of the Financial Sector

In order to gain a comprehensive overview of existing tax regimes applied to the financial sector, four different tax areas have been analyzed.[29] The studies looked at the statutory differences in tax provisions between the financial sector and the other sectors. They cover the situation in 2011 in Corporate Income Taxation (CIT), VAT and labour taxation, as well as the tax treatment of main financial instruments. Their results are presented in Annex 3. Broadly speaking, the study does not find any significant differences in the tax treatment of the financial sector compared to other sectors, with the main exception of VAT for which the financial sector is granted exemption as discussed in detail above.

In labour taxation, there are no differences in the treatment of personal income of workers employed in the financial sector. One difference though (albeit temporary for some Member States) is that several Member States have introduced bonus taxes on the financial sector. This would lead to over-taxation in personal income tax. Another point is that in a limited number of countries stock options and bonuses benefit from a favourable tax treatment. This treatment is however available for all sectors. It may be the case that the financial sector has a pay structure more prone to these pay schemes leading to a lower effective tax burden. This was however outside the scope of the study and the correspondents of PwC did not have the view that this was the case. However, the study on executive compensation in the financial sector in Annex 4 finds evidence that the financial sector relies more heavily on variable compensation compared to other sectors. The share of salary in total compensation is around 10% in the financial sector while around 14% in the industrial sector and 13% in the consumption goods sector and 11% in other sectors.

In CIT, two main differences between financial and non-financial corporations concern the treatment of bad and doubtful loans and the non-application of thin cap rules to the financial sector. In the case of bad and doubtful loans, the differential treatment may provide a cash-flow (liquidity) advantage, but not a tax advantage. These differences in treatment can however be explained by the structure of the business in the financial sector for which interest received and paid constitute part of the business and not just the financing of activities. In the Member States in which there are these differences, they are explicitly made to take this situation into account.

The taxation of financial instruments does not seem to lead to specific tax advantages in most countries reviewed, even if in many countries the treatment for accounting and/or tax purposes of financial instruments held by financial institutions differs from its treatment when held by non-financial institutions. However, there is no evidence that this results in an advantage for the financial sector.

3.1.5.2. Recent Unilateral Actions by Member States

Rationale for implementation

The public debate on financial sector taxation has also considered levies on financial institutions, which are designed as a charge on financial institutions to cover the net fiscal cost of direct public support to financial institutions and help reduce excessive risk-taking. Those are often seen as linked to an effective resolution mechanism, which should however avoid

[29] Additional information and data on the current taxation of the financial sector was presented in the Commission Staff Working Document SEC(2010) 1166/3.

aggravating the issue of moral hazard, i.e. that it should not give a wrong signal that the receipts would be used to support failing institutions.

National measures

Ten Member States have so far introduced country specific systems of (bank) levies whose characteristics (base, rate and scope) differ considerably. In terms of the use of revenues, in some Member States those do not form part of a resolution mechanism, but contribute to the general budget instead.

Risks of double taxation and spill-over effects

As already outlined in Section 3.3, the financial sector is characterised by higher mobility of the tax base. National measures have attempted to address this issue by broadening the geographical scope of their measures to encompass even situations that would not normally be subject to corporate income taxes. That approach greatly increases the risk of double (and multiple) taxation and spill-over effects.

Where the home Member States would charge the tax on banks' branches situated abroad and the host Member States would charge the same branches and subsidiaries, there is a significant risk of double charging. This issue is aggravated if a Member State decides to also make subject to the charge the whole banking group, including subsidiaries situated abroad. The latter may potentially lead to multiple taxation in situations involving more than two Member States, e.g. for a branch of a lower-tier subsidiary in a home Member State group. Unfortunately, it appears that double taxation/charging issues with regard to such balance sheet taxes cannot be solved by the double tax treaties concluded among Member States in their current form.

3.1.5.3. Reform of the regulatory framework after the crisis

The following regulatory changes should be considered as constituting the baseline scenario from a regulatory perspective. The reforms address a number of problems identified above: reduce risk taking (proposals 1-10), risk surveillance (proposal 2), the definition and creation of proper capital ratios (proposals 1 to 7), misaligned incentives in remuneration schemes (proposal 1), a harmonisation of deposit guarantee schemes and the covering cost of future crisis (proposals 8 and 9), and dealing with Automated Trading (proposal 10). The relevant proposals are (see Annex 2 for a description of the measures):

(1) The definition of capital under CRD III and CRD IV

(2) The revision to the counterparty credit risk under CRD III and CRD IV

(3) The treatment of the trading book under CRD III and CRD IV

(4) The changes related to securitizations under CRD III and CRD IV

(5) The liquidity ratio under CRD IV

(6) The capital conservation buffer under CRD IV

(7) A calibration of the higher minimum capital ratios, under CRD IV

(8) A harmonised DGS

(9) The setting up of bank resolution fund

(10) Regulatory measures for High Frequency Trading (Algorithmic or Automated trading)

3.1.5.4. Problems taken up by the current baseline scenario

With the implementation of the regulatory reform package targeting the financial sector, several of the risks and problematic developments identified in the previous sections will be - at least partially - addressed. This mainly holds for the market failures described in section 3.1.3, except perhaps the risk of short-sighted profit-seeking behaviour by some actors in the financial sector.

Other issues are not addressed by these measures, such as the under-taxation of the financial sector, and the absence of a fair and substantial contribution of the financial sector towards paying any burden associated with the present crisis.

3.2. EU right to act and justification

3.2.1. EU right to act

In general, action at EU level is necessary in this field due to the high integration of the financial sector within the EU. The financial sector, driven by the developments in information technology, is characterised by high mobility and relatively high independence of the financial activities from the physical placement of the economic operators, high substitutability of financial products and financial product "innovation". The outlined characteristics call for harmonised measures in order to retain the level playing field at EU level. As more fully explained below in Section 5 when defining the different taxes analysed, a substantial degree of harmonisation is considered as essential in order to minimise distortions of the Internal market upon introduction of a FTT or a FAT. The following subsections address in more detail the conditions of the possible legal bases, as well as the issues of subsidiarity and proportionality.

3.2.2. Legal Base

Harmonisation rules in the area concerned would be based on Article 113 or on Article 115 of the Treaty on the Functioning of the European Union (TFEU).

Box (2). Articles TFEU

Article 113 TFEU

The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation 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.

Article 115 TFEU

Without prejudice to Article 114, the Council shall, acting unanimously in accordance with a special

legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.

Both Articles entitle the EU to adopt legal provisions for the approximation of Member States' legislation, even if under slightly different conditions. Article 113 TFEU constitutes the legal basis for the adoption of legal provisions only if these govern turnover taxes, excise duties or any other indirect tax. As an FTT would be in the nature of an indirect tax, Article 113 TFEU would provide the relevant legal basis.

Article 115 TFEU is more general in nature. It entitles the EU to adopt directives for the approximation of Member States' laws governing various fields, but not those covered by the more specific rule contained in Article 113 on indirect taxation. Since an FAT would ultimately be akin to a direct tax, Article 115 TFEU would constitute the appropriate legal basis for its harmonisation.

Most often, "harmonisation" or "approximation" concerns existing national legislation. However, it is settled case-law of the Court of Justice that it can be used as a legal basis if the aim is to prevent the emergence of future obstacles to trade resulting from multifarious development of national laws. The emergence of such obstacles must be likely and the measure in question must be designed to prevent them[30].

Therefore, under any of the aforementioned legal basis, the main rationale for EU action in the field of financial sector taxation is that the functioning of the Internal Market would be hampered by the operation of uncoordinated national legislation. And indeed, such uncoordinated legislation regarding taxes on the financial sector could fragment the EU financial market, distort competition and increase the risks of relocation of the financial activities within the EU.

The European Council stated in its conclusions of its meeting on 17 June 2010 that "the EU should lead efforts (…) for introducing systems for levies and taxes on financial institutions". At least 10 Member States have introduced or, are analysing the possibility of introducing, bank levies on financial institutions.

Therefore, to an extent, tax obstacles have already been created, namely by the existing legislation of ten Member States. Moreover, other Member States are (unilaterally) considering the imposition new taxes upon the financial sector. Member States wishing to impose new taxes on financial institutions attempt to learn from the experience of those countries that already apply similar types of taxes but, as more fully explained in Annex 8, these experiences vary significantly, and it is unlikely that, without a certain degree of coordination, the different Member States concerned follow a unique model.

Non-coordinated action, planned and implemented by each Member State on its own would aggravate the current situation. It would further contribute to distorting the internal market for financial services, as the cost associated to them would vary across Member States. It would also increase the risk that the financial sector becomes subject to double taxation, which would in turn hinder the exercise of the fundamental freedoms protected by the TFEU[31]. The double taxation provoked by the non-coordinated introduction of bank levies by two or more

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30 Judgment of 08.06.2010 in Case C-58/08, Vodafone Ltd, , paragraph 33 with further references.

31 See also the example for double taxation under 5.2.6.

Member States provides a good illustration of this problem. Where home Member States would charge the tax on banks' branches situated abroad and host Member States would charge the same branches, there is a significant risk of double charging, which cannot be solved by the double tax treaties concluded among Member States in their current form. The potential cost of non harmonisation for the financial institutions could be significant. Bilateral agreements would only lead to imperfect solutions as long as there is no fully fledged network of such agreements between all Member States concerned. The creation of such a network, if it were achieved at all, would take considerable time. The introduction of a FTT on the basis of the residence principle in one Member State A, and on the basis of the source principle in another Member State B would lead to exactly the same situation of double charging. A certain financial transaction undertaken by a resident of State A would be subject to State A's FTT; and it would also be subject to FTT in State B if the taxable event is situated there.

Furthermore, a non-coordinated introduction of taxes on the financial sector is also likely to favour situations where taxation in one or more Member States coexists with non-taxation in other Member States. Such a situation would distort the proper functioning of the market since it would increase the incentives for relocation of the financial activities within the EU. Under the example above, there is a high risk that financial transactions are driven out of Member State B in order to avoid the tax, as the Swedish experience with its financial transactions tax shows.[32]

Consequently, harmonisation at EU-level in this field is essential in order to avoid that distortions hamper the proper functioning of the internal market in a field in which Member States have acted or appear determined to act: the financial sector.

For the reasons already given, the need for harmonisation extends, among other things, to the issue of tax rates. It must be avoided that important differences in this area lead to appreciable tax arbitrage or other damaging effects.

3.2.3. Subsidiarity

EU action in the field of financial sector taxation would respect the subsidiarity principle, because the internal market objectives pursued cannot be achieved by the Member States acting unilaterally, but can only be achieved at Union level. Unilateral action by Member States creates the internal market problem described above, it does not solve it. . Reference is made to the explanations given in the previous subsection. By way of further illustration, it is useful again to refer to the example of Sweden (explained in more detail in section 3.1.4. and Annex 8), which clearly shows the limits of a unilateral introduction of such a measure given the high mobility of the sector. Sixty per cent of the trading volume of the eleven most actively traded Swedish share classes moved to the UK after the announcement in 1986 that the tax rate would double; 30% of all Swedish equity trading moved offshore. Five years after the introduction of the tax, more than 50% of all Swedish trading had moved to London. Foreign investors reacted to the tax by moving their trading offshore while domestic investors reacted by reducing the number of their equity trades.

[32] By the same token, the intended budgetary effects in the Member States applying the tax would be undermined.

3.2.4. Proportionality

The options set out in detail in section 5, while differing in focus, are all in keeping with the principle of proportionality, since they do not go beyond what is necessary to achieve the objectives pursued.

Notably, in order for the internal market to function properly, it is necessary to harmonise the tax base and to fix a minimum tax rate. In this latter regard, it is worth noting that Member States would remain free to set higher than the minimum rates fixed at Union level, should they consider this to be appropriate.

Section 5 explains in more detail the focus of the various options and how each of them achieves its more specific objectives.

The options envisaged are also proportionate as regards the issue of administrative costs, which indeed are reduced to a minimum. A harmonised FTT would be based on the transactions registered in the trading books and thus on data readily available. Equally, a harmonised rent- or risk-taxing FAT would be based on adjusted profit and loss accounts set up by all financial institutions and used, also, as a starting point for corporate income taxation.

4. OBJECTIVES

4.1. Raising revenue and adequate contribution from the financial sector to tax revenues

Raising revenue is a natural goal for any new tax and one important driver in the debate of financial sector taxation. There are many different political motives for generating additional revenue from the financial sector, partly based on the problems set out above: consolidating public finances, collecting a 'fair' contribution from the financial sector in order to cover the cost of recent and future crises, balancing any potential advantages from the VAT exemption of the financial sector, taxing economic rents and, more generally, collecting new funds for budget consolidation or other general budget purposes.

In the case of financial sector taxation the general view is that an EU-wide tax approach might be necessary or at least preferable. One reason for this demand for full ex-ante coordination is that policy makers as well as the public and academic world argue that the high mobility of the activities of the sector under consideration might lead to strong relocation and substitution effects which could cast doubt on the effectiveness of purely national tax measures as revenue tools. Whether this is indeed the case for all instruments under consideration is part of the subsequent analysis. In addition, because such revenues would be raised from coordinated international taxes, their possible use for financing global public goods or international policies could more easily be agreed upon.

The general objective of raising revenue from the financial sector can be broken down into more specific policy objectives that the introduction of taxes on the financial sector could pursue, as follows:

(1) Identify new revenue sources

The recent crisis as well as the high degree of debt in some Member States partly due to the economic downturn following the financial crisis has led governments to search for new

sources of tax revenue in order to meet their budgetary needs. In fact, there are numerous ways to increase tax revenue. New taxes could be one way but raising current taxes or reforming and improving them to generate additional revenues by closing loopholes, improving international co-ordination and reducing compliance costs would be other options. Improving existing tax policies, e.g. removing the debt-equity bias in CIT and policies directed at improving economic growth are very important means to increase the taxable bases and boost revenue. However, these potential policies will not be part of the policy options discussed here[33].

It is to be noted that new revenue sources that would be generated across the EU could also be taken into account in decisions on the sourcing of new own resources for the EU (see in particular point 7.6.4). *(2) Recover costs of the recent financial crisis from the financial sector*

This objective is backward-looking and based on the idea that it is fair that the financial sector contributes to the cost of the crisis as it contributed to its occurrence and size. In contrast to other sectors of the economy, allowing banks and other systemic financial institutions to fail might – because of the size and the interconnectivity amongst the institutions – have negative consequences for the economy as a whole. There is no simple way for a bank to continue to provide essential banking functions whilst in insolvency, and in the case of a failure of a large bank, those functions could not be simply shut down without significant systemic damage ('too-big-to-fail'). Therefore, in an internationally coordinated effort, governments were forced to stabilise the financial system by substantial financing support. This led to the problem that a large part of the profits made before the crisis were privatized while the losses during the crisis were borne mainly by the general public and therefore socialized. Collecting a contribution from the financial sector to mitigate the costs incurred during the last crisis is thus an argument for raising revenue from the sector. However, it should be noted at this stage already that there are serious difficulties to design a tax that ensures that the economic incidence of the tax (the real economic burden) falls only on those banks that caused the crisis. Some of these banks may not exist any longer. *In fine*, the taxes are borne by individuals (bank stakeholders), including their clients, shareholders and/or employees. It is also a fact that if designed as an ex-post contribution, the tax fails to target financial companies that went bankrupt. Furthermore, many financial institutions have survived the crisis without direct public support. This latter argument should however be balanced by the fact that the absence of a need for public support to some banks may simply be due to the fact that public support to other specific financial institutions was enough to ensure that those banks were holding protected assets. Because of strong interdependencies in the sector, public support to financial institutions 'in the first line' also spilled over to the other financial institutions.

(3) Cover the costs of potential future financial crises

A related argument relies on the unavoidability of future crises despite the fact that regulatory efforts will reduce this risk. From this forward-looking perspective tax revenues raised from the financial sector are needed to ensure that the costs of future crisis are not or not entirely borne again by the taxpayers. For this reason, some countries have formed resolution funds and have imposed a certain contribution on banks to finance them (bank levies).

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[33] See e.g. European Commission (2010g) for such a discussion.

However, it could be justified that the financial sector contributes to the public budget with further taxes, in order to cover future crises costs that go beyond the national or EU[34] resolution mechanisms thereby avoiding that all taxpayers have to pay for them.[35] This argument is based on the debatable assumption the financial sector bears the main responsibility for financial crises.

(4) Compensate for VAT exemption of financial services

There are convincing arguments that the VAT exemption of the financial sector constitutes a tax advantage. To the extent that the financial sector's size might be inflated as a consequence of the implicit state guarantees and the VAT exemption (estimated above at about 0.15% of GDP), a properly designed additional charge would reduce the tax advantage of the financial sector.

Policy instruments directed at the financial sector should address this issue. Ideally, the VAT exemption under the current tax system should be revisited by amending the actual Directive in order to allow for a more general taxation. Such a proposal is not part of the current initiative discussed in this report.

4.2. Limiting undesirable market behaviour and thereby stabilizing markets

To complement the extensive financial sector reforms underway, taxes ideally should contribute to enhancing the efficiency and stability of financial markets, reducing their volatility, internalizing potential negative externalities as well as the harmful effects of excessive risk-taking. This objectives might however be competing with raising revenue. For instance, a study commissioned by the European Parliament (von Weizsäcker and Darvas, 2010)shows that a financial transaction tax could have some beneficial effects if the tax rate is very low . However, the study concludes that other taxes would be more promising as a tool for raising revenue.

Four specific objectives can be distinguished in this respect:

(1) Reduce incentives for excessive risk-taking and short-sighted profit-seeking

Incentives to engage in excessively high-risk investment stimulated either by implicit state guarantees, excessive remuneration schemes or complex financial transactions could be reduced by measures explicitly taxing risk-taking. Via this way, systemic risk could be internalised to some extent.

Furthermore, if financial instruments or trading strategies are designed in a way that they reward long-term strategies and sustained investment at the expense of pure short-term profit-seeking investment, e.g. through automated high-speed trading taxation might be a corrective tool in this respect.

(2) Address specific risks posed by automated trading

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[34] See Annex 2 with regard to the initiative to set up a bank resolution fund.

[35] The question how potential revenue could be spent is not part of this impact assessment.

Automated Trading in financial markets could be counter- measured by a tax-induced increase in transaction costs, so that these costs would significantly erode the marginal profit from individual transactions carried out such high-frequency trading.

(3) Reduce leverage – debt-equity ratio

The distortion of financing decisions and the increase of leverage caused by the different tax treatment of debt and equity could be corrected by taxes which curb the difference that the current corporate tax systems actually contain. This could be a debt/ equity neutral tax system or measures which provide incentives to finance via equity. A well-designed tax base that reduces the leverage distortion could make companies less vulnerable to a short-term reduction in credit available on the capital market.

(4) Reduce tax-induced economic distortions

Furthermore, while above objectives relate to possible improvements of suboptimal economic behaviour or economic structures, an additional overarching objective with regard to new tax instruments is to avoid distortions of efficient current behaviour of market structures. For example a shift from one form of financial activity to another one purely for tax reasons might very well be undesirable as just raising tax-induce economic distortions. Annex 16 discusses the efficiency aspects in more detail.

However, tax measures must also be put into a broader context of current efforts on regulatory reform of the financial sector, in particular with likely higher capital requirements. The cumulative impact of such measures must be borne in mind (especially if they are not carefully coordinated and phased in), so that a viable EU financial sector, able to properly and efficiently finance the real economy, is not put at risk.

4.3. Internal Market aspects (avoid double taxation and distortion of competition)

EU Member States are starting to put in place national tax instruments to respond to some of these challenges. It is important that such developments take place in a coordinated framework. If not, different national systems levied on diverging tax bases could create incentives for tax arbitrage and result in allocation distortions between financial markets in the EU (or to relocation of business outside the EU). The emergence of uncoordinated national solutions could also lead to double or non-taxation and fragmentation of the financial sector, hampering the proper functioning of the Internal Market.

Table (3). Overview of problems and related objectives

General Problems	Specific problems	General objectives	Specific objectives
Costs of the crisis (Fiscal consolidation issues) Tax advantage for the financial sector	Substantial public financial support and other budgetary effects of the financial crisis led to need for budget consolidation VAT-exemption of financial services	Raising revenue Adequate (fair and substantial) contribution from the financial sector	(1) Identifying new revenue sources
			(2) Recover costs of the recent financial crisis
			(3) Cover the budgetary costs of potential future financial crises
			(4) Compensate for VAT exemption of financial services
Market failure and systemic risks in the financial sector	(1) Undesirable market behaviour due to implicit guarantees (moral hazard)	Reducing undesirable market behaviour and thereby stabilizing	Reduce incentives for excessive risk-taking incentives

	(2) Not properly managed and supervised automated trading	markets	Address specific risks posed by automated trading
	(3) Distortions of debt-equity choice: Leverage (4) Excessive executive compensation schemes encourage risk-taking		Reduce leverage – debt-to-equity ratio
	(5) Complex products and counterparty risk	Ensuring the functioning of the Internal Market by a coordination of the measures to be introduced	Avoid distortions within the EU, ensure efficiency of the measures and safeguard relative competitive position within the EU
	(6) Economic rents		Avoid double taxation

5. POLICY OPTIONS

The lines that follow contain alternative policy instruments that can be used to tackle the problems described above under Chapter 3.

Some policy options, such as tighter regulation of the financial sector only or increasing taxes not narrowly related to the financial sector and its activities (such as higher personal income tax rates or an increase in the minimum rate of VAT) have been discarded at an early stage. Either they are already under preparation under other policy initiatives and therefore already included in the baseline scenario, or they do not contribute to the core objective of the policy initiative, i.e. raising revenues from the financial sector and its activities.

Also, bringing an end to the VAT exemption will not be analysed in this Impact Assessment, as this options will be analysed in the context of the general reform of the European VAT regime that is presently under preparation. A Green Paper on this subject had been published by the Commission in December 2010[36], and the corresponding public consultation has come to an end just before summer 2011.

Thus two policy instruments are retained for further analysis. These two different taxes on the financial sector are a Financial Transactions Tax (FTT) and a Financial Activities Tax (FAT). The objective is to outline in this chapter the basic elements of those policy instruments, more concretely, the scope of application of the tax, the taxpayer, the taxable base, the tax rate and the available methods to avoid double taxation and relocation. For most of these elements, several technical alternatives are considered.

5.1. Baseline (no tax policy change)

The baseline scenario has been presented in section 3. Table (4) summarizes the links between the policies taken in the baseline scenario (no action on tax measures). The baseline scenario addresses the risk related objectives with a number of different policies. All regulatory measures listed in section 3 and described in detail in Annex 2 are directed at decreasing the individual as well as the systemic risk in the financial sector by increasing capitalization and capital buffers for both the financial institutions and the financial system as a whole. The

[36] COM(2010)695 of 1.12.2010: Green paper on the future of VAT: towards a simpler, more robust and efficient VAT system.

main areas not addressed in the baseline scenario are the VAT exemption of the financial sector as well as the recovery of the costs of the recent financial crisis.

Table (4). Objectives and policies taken in baseline scenario

General objectives	Specific objectives	Policies in Baseline Scenario
Raising revenue Adequate (fair and substantial) contribution from the financial sector	(1) Identify new revenue sources	Not addressed
	(2) Recover costs of the recent financial crisis	Not addressed
	(3) Cover the budgetary costs of potential future financial crises	EU Crisis management and resolution fund, Harmonised DGS
	(4) Compensate for VAT exemption of financial services	Not addressed
Reducing undesirable market behaviour and thereby stabilizing markets	Reduce incentives for excessive risk-taking	CRD III and IV, remuneration reform etc.
	Address specific risk posed by automated trading	MIFID review
	Reduce leverage – debt to equity ratio	CRD III and IV, Bank levy
Ensuring the functioning of the Internal Market by a coordination of the measures to be introduced	Avoid distortions within the EU, ensure efficiency of the measures and safeguard relative competitive position within the EU	Creation of European Supervisory Authority, common resolution framework, DGS rules etc
	Avoid double taxation	Not addressed, relevant in the field of resolution financing (bank levy)

Given the overlap of objectives it is necessary to clarify whether taxation and regulation could be combined in order to reach the objectives in table (4) or if the cumulative effect of two instruments for one goal might be detrimental in some cases. When regulation is already existent and set at a level considered socially optimal, there is a strong case for implementing a resolution fund as a complement to the new regulatory framework as it reinforces the likelihood that the capital ratio set out by regulation is sufficient to internalize the social marginal damages of a crisis. There is also a strong case to finance this resolution fund with a corrective (Pigouvian) tax (e.g. bank levy) or another tax (e.g. FAT) as, in the worst case, they do not alter the behaviour from the social optimum and – in the best case – they reinforce the benefits of a resolution fund. In this respect, the option that is the most likely to reinforce the benefits of a resolution fund is a bank levy.

5.2. Policy option 1: Financial Transaction Tax

The FTT can best be defined as a "group of taxes", these taxes share a common root, i.e. the taxing of trading in financial instruments such as shares and bonds and of trading in derivatives thereof. But they may nevertheless differ considerably, depending on the products and markets covered. What they have in common is that on individual transactions (typically the selling and buying of a financial instrument (or of a derivative thereof) a tax is levied as a percentage point of the value of the transaction. In contradiction to the perception of the general public, an FTT is typically not levied on each financial transaction (such as paying bills or transferring money) per se, but only on transaction with well-identified financial products.

The main reasons for the introduction of financial transaction taxes (FTT) are raising revenue from the financial sector, establishing a new source for financing public budgets and - to a lesser extent - curbing undesired "speculative" or c much leveraged trading, while maintaining the competitiveness of the EU financial industry. Generally, all version of FTT are levied at a comparatively low rate on financial transactions, typically each time a financial instrument is issued and/or exchanged.

There are numerous options in designing a FTT, which address the abovementioned policy goals and concerns. Those are described in greater detail in chapter 7 and Annex 7.

5.3. Policy Option 2: Financial Activities Tax

The FAT can also best be defined as a "group of taxes"; these taxes share a certain common root but may nevertheless differ considerably. In essence, the FAT would be levied on the sum of profit and remuneration of financial institutions, since one common rationale behind all the forms of FAT is the fact that would a rent occur, it will go either to shareholder in terms of higher profit (dividends or capital gains) or to workers (via higher remuneration). However, as more fully explained below, a FAT can take several possible forms depending on how profit and remunerations are defined and which objectives are pursued with the introduction of the tax.

There are numerous options in designing a FAT, which address the abovementioned policy goals and concerns. Those are described in greater detail in Annex 7.

5.4. Other policy options

Some of the objectives can also be reached by employing or modifying existing policies. One example is the VAT exemption where a natural starting point is the modification of the existing VAT system to deal with the exemption. Another example is the problem of the debt equity choice, which is best addressed in current Corporate Income Tax (CIT) systems. Furthermore, the baseline scenario contains a number of regulatory policy initiatives directed at the general issues of systemic risk and misaligned incentives in the financial sector. These options have been discarded and are not analysed here, as explained in the beginning of this chapter.

6. COMPARING FTT AND FAT

Looking at the objectives to be achieved, each of the general policy options, FTT and FAT, is compared against three criteria: effectiveness, efficiency and policy coherence. Effectiveness refers to the capacity of reaching the objectives defined in Chapter 4. For example, one objective is the capacity of raising revenue. In this context the important question of potential relocation will be taken into account. Efficiency refers to the costs that the policy options entail for reaching the defined objectives, such as e.g. an increase in the cost of capital. In a broader sense, the efficiency criterion takes into account potential negative economic impacts of the policy options. Finally, policy coherence refers to how well each options serves EU general policy objectives, with specific regard to the financial sector, those underlying the recent initiatives put in place to improve financial stability through enhanced supervision and

regulation. This includes an analysis of the cumulative effects resulting from regulatory measures and the policy options.[37]

On the basis of the assessment of impacts and associated risks preferred options for both FTT and FAT are identified.

6.1. Raising revenue and adequate contribution from the financial sector to tax revenues

6.1.1. Identifying new revenue sources

Both tax instruments – FTT and FAT – could be new revenue sources as they are able to generate significant amounts of tax revenue for public budgets.

For the FTT, the estimates presented here rely on data from the BIS and FESE. The main difference between the figures 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) for a tax rate of 0.05%.

For the FAT, we also have two scenarios. The first one assumes that rents only are affected, triggering no relation effects. In the second scenario, we assume a relocation of subsidiaries of non-EU foreign financial companies by 40% and a relocation of foreign EU subsidiaries by 5%. On top of this, we assume a fall of 35% in the reported profit of remaining banks.

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.

The revenue estimates are reported in detail in Annex 11.[38] These assumptions on elasticities and decrease in volumes of transactions are based on the results of the review of the empirical economic literature as shown in annex 9. 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 (see tables 11a and 11b in Annex 11). 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). An FTT on currency transactions (spot and derivatives) would generate EUR 8.5 billion (0.07% GDP) in scenario 1 and EUR 11.8 billion (0.10% GDP) in scenario 2.

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[37] The detailed analysis of various economic aspects of the two taxes is presented in the various annexes.

[38] See also section 6.3.1. for a discussion on these relocation risks.

The addition-method FAT, the Rent-Taxing FAT and the Risk-Taxing FAT at a rate of 5% for EU-27 are respectively EUR 30.3 billion, EUR 18.9 billion and EUR 13.6 billion under the scenario that the taxes do not trigger relocation. This corresponds respectively to 0.26%, 0.16% and 0.12% of EU-27 GDP for 2009. Once relocation possibilities are taken into account, potential revenues could drop to EUR 24.6 billion, EUR 12.4 billion and EUR 9.3 billion respectively.

While both instruments 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 (see Section 6.3). 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 and/or products might disappear. This could have far reaching potential impact on the financing of investment projects. A more direct way to assess the efficiency of the policy options is to look at the direct costs of administering the taxes. The costs of collecting the FTT might vary substantially depending on the exact design of the tax, but is typically estimated to be rather low as compared to the collection costs for other taxes. They are, nevertheless relatively high if the tax residence principle is adopted for all transactions. If only the trading by the financial sector is targeted, the tax residence principle could however be a cost-effective option since it would use the books of banks directly. Administration of the FAT also raises some issues linked to the scope of application in an international setting, although they look less severe given the similarity with the CIT.

The analysis of macroeconomic impacts (and the relocation issues mentioned above) suggests that the economic distortions related to raising revenue could be lower with a FAT compared to an FTT. Model simulations indicate that the short-term effect of a 5% FAT on GDP could be limited to around 0.10% while the long-term effect is simulated to reach about half a per cent (deviation of GDP from its long-run baseline), against annual tax revenues of around 0.2% of GDP. On the other hand, a stylised transaction tax on securities (STT), where it is assumed that all investment in the economy are financed with the help of securities (shares and bonds) at 0.1% is simulated to cause output losses (i.e. deviation of GDP from its long-run baseline level) of up to 1.76% in the long run, while yielding annual revenues of less than 0.1% of GDP.

With regards to the economic incidence and the equity aspects of the taxes, the FTT would likely be progressive and its ability to burden the sector depends on its design. The incidence of the FAT will largely depend on its design but, given the available empirical evidence for the CIT, there is reason to assume that the tax burden will partly be shifted via higher interest rates spreads.

6.1.2. Recover costs of the recent financial crisis

As already pointed out, this objective raises the question whether one can reasonably assume that the budgetary cost of the recent crisis can be recovered fully ex-post. It seems difficult to argue along this line in cases where banks involved in the crisis have been nationalized or

restructured. However, one might argue that the financial sector as a whole benefited from the financial aids granted and that a tax on all financial institutions could be justified.

The economic incidence the two taxes is difficult to determine, although like for every other (sector-specific) tax or cost increase, the taxed persons will try to pass the higher tax onto their clients, independent of the legal incidence of the tax. For the FTT, the legal incidence will fall on financial institutions when applying the tax residence principle and taxing only transactions of the financial companies. The economic incidence is less clear. While it will also fall on the users of financial services, it could affect the financial sector that carries out a large share of financial transactions. In fact, in foreign exchange markets and in over the counter (OTC) interest derivatives trades of the non-financial sector were respectively only 13% and 11% of the total in April 2010.[39] The FAT faces similar problems since its burden could partly be shifted by banks to the final consumer through higher interest rate spreads. However, since the FAT falls on profits and remuneration it is more closely linked to the activity of financial institutions.

The efficiency of the two instruments in achieving this objective needs to be assessed against the costs that these options entail, already discussed above.

6.1.3. Cover the costs of potential future financial crises

To cover the potential costs of future crisis due to banking sector resolution the Commission plans to adopt proposals in the framework an EU crisis resolution framework. In addition, a number of Member States have already introduced bank levies, which serve the purpose of either financing resolution or the general budget in order to make the banking sector contribute to the costs of potential future crisis beforehand. In fact, the so-called polluter-pays-principle might serve as a justification for the financial sector to contribute further to the government budget with a view to covering the costs of future crises that go beyond the resolution mechanisms. Such costs would otherwise have to be borne by all taxpayers.

The considerations above on the effectiveness of the policy options in targeting the financial sector apply also to the present objective. The risk of the banks' loans portfolios can generate losses that would not be absorbed by banks' provisions and by the instruments envisaged under the Capital Requirements Directive Proposal (CRD IV) that adopts Basel III rules, the proposed strengthening of the Deposit Guarantee Schemes, and the EU crisis management and banks resolution framework that includes resolution funds.

6.2. Compensate for VAT exemption of Financial Services

The transaction taxes as discussed in this paper are not really effective to compensate for the VAT exemption for mainly two reasons. The major part of the exemption is due to the margin based business of the banks when receiving deposits and granting credit. The transaction proposals discussed here explicitly exempt depositing and loans from the tax base. For this reason the FTT would not capture the value-added sufficiently. There is no connection to the EU-VAT system, which aims at a neutral and non-cascading taxation and to the value added of the services involved in the trading or creation of products.

[39] See Annex 12.

The FAT and namely the addition-method FAT could be more effective in addressing the VAT exemption in the sense that the tax base has similarities to the VAT base. However, the integration of VAT and FAT is complicated and poses a number of unresolved problems.

The ideal solution to address the VAT problem remains to fix the issue within the current VAT system. This issue will be discussed in the context of the Green Paper on VAT.

6.3. Correcting undesirable market behaviour and thereby stabilizing financial markets

6.3.1. Reduce incentives for excessive risk-taking

To the extent that short-term trading would create systemic risks the FTT might be an appropriate tool to reduce this type of trading, as it would increase the costs of frequent short-term transactions much more than those for long-term investment transactions.

The only FAT version that in theory addresses risk-taking is the risk-taxing FAT. The addition-method and the rent-taxing FAT do not tackle this issue. However, the FAT is an indirect measure to tackle risk-taking since it assumes a direct link between high profit and high risks. The taxation of risk-taking is essentially mimicked by taxing the result of the risk taking (high profits) while not allowing deduction of losses.[40]

Therefore, regulatory measures more closely linked to the sources of systemic risk might be more appropriate to deal with excessive risk taking. The preference for regulatory measures to address this specific objective is reinforced once one takes into account the direct and indirect costs (discussed above) that would be generated by the tax instruments.

6.3.2. Address specific risks posed by automated trading

The FTT, de facto increasing the costs of transactions in financial markets, could be used as a measure to reduce Automated Trading, and notably its subset of High-Frequency-Trading, which could be interpreted as using informational rents. The effects of additional transaction costs might be particularly strong on some market segments characterised by very narrow spreads.

The FAT targets directly (some measures of) profits and remuneration of financial intermediaries – including profit made by automated and high-speed trading –, but it does not have a direct impact on the trading behaviour in financial markets.

6.3.3. Reduce leverage

Neither the FTT nor the FAT address the distortions of financing decisions and the incentives to excessive leverage created by the different treatment of debt and equity under the current corporate tax systems. This could be done by a debt/ equity neutral tax system or measures which provide incentives to finance via equity.

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[40] Further analysis of the connection between FAT and systemic risk is made in annex 14 using the SYMBOL Model. It shows that FAT1 is well correlated with individual contributions of banks to systemic risks. This is because it is well correlated to size, a characteristic considered to be linked to risk.

In principle, two alternative corporate tax systems exist that might eliminate the distortion between debt and equity by treating both sources of finance in the same way: an Allowance for Corporate Equity (ACE) or a Comprehensive Business Income Tax (CBIT). The ACE would grant a deduction for return on equity (new or total equity) as it is the case for interest paid and would hence reduce or abolish the tax advantage of debt. The CBIT system would achieve the same result by denying interest deductibility at the corporate income tax. The two alternative systems exert opposite effects on the tax base, hence they are not equivalent in terms of potential generated revenues, ceteris paribus (see Annex 18).

With specific regard to banking intermediaries, the revision of the Capital Requirements Directive (CRD IV) envisages measures to discourage leverage. Such provisions are to be preferred to the policy options under analysis in terms of effectiveness and efficiency. As a part of the new EU regulatory framework for financial services, they are also consistent with the more general EU policy objectives of improving financial stability.

In some cases – e.g. contracts for differences – derivatives are highly leveraged. In such case, a FTT based on the market value would have a taxable base which is much lower than the underlying. The design of a FTT shall address this problem.

6.3.4. Taxing economic rents - Introduce measures to tax value added in the financial sector?

The FTT does not tax economic rents as such but rather the transactions in financial markets that could generate some rents. If these transactions are the main source of revenue for financial institutions, the FTT could implicitly decrease rents. This would especially hold for rents generated by high-frequency trading and frequent narrow-margin short term transactions. However, the current literature suggests that the larger part of profits is generated in other fields of activity namely credit intermediation (which would be tax free under an FTT as considered here) and fees. Systemically relevant institutions might also generate certain gains via lower funding costs because an implicit bailout could be factored into the rate at which investors lend to financial institutions (see for example Ueda and Weder di Mauro (2010) for a calculation of the value of the subsidy expressed as funding cost advantage to be 10 to 50 basis points). In this case the FTT would have limited merits as a tax on economic rents.

The rent-taxing FAT is specifically designed to tax economic rents by allowing a deduction of returns, which correspond to normal market return realized in other sectors. While this is an efficient approach to tax economic rents, the effectiveness will depend on the applicability of the notion of normal returns to the tax base, and the economic tax incidence.

6.4. Ensuring the functioning of the Internal Market

6.4.1. Avoid distortions within the EU and safeguard competitiveness of the EU

In order to ensure the functioning of the Internal Market and to minimize economic distortions within the EU, tax instruments should be introduced ideally when a high degree of coordination or harmonisation of the tax bases as well as rates can be reached. Notably for the case of an FTT with its internationally highly mobile tax base, a first step could be the creation of an international classification or financial instruments traded and to be taxed in order to create common ground for identical definitions of the scope and the base for a transaction tax. Since the FAT is largely based on national accounting data and to some extent

on existing national tax base definitions, its implementation could be envisaged also nationally. In this case coordination of national measures is advisable since profit shifting and relocation of subsidiaries could otherwise occur. Furthermore the possible introduction of such taxes must be decided bearing in mind the ongoing change in the regulatory framework of the financial sector that will lead to additional costs, in particular in the banking sector.

6.4.2. Avoid double taxation

FTT and FAT should be introduced in a coordinated way to avoid double taxation or non-taxation by the application of different taxation principles (residence, source or issuance principle).

6.5. Cumulative effects

The consequences of a possible introduction of any type of FAT or FTT is to be analysed in the light of the cumulative impact of such measure with the various regulatory measures currently envisaged under BASEL III (in particular the new capital and liquidity requirements), the introduction of harmonised Deposit Guarantee Schemes rules as well as a possible bank levy to finance resolution funds. While the size of the effects of regulatory changes depends on assumptions about the direct pass-through of higher capital requirements into the cost of capital, a general conclusion is that for both FAT and FTT, the impact on most economic variables of interest simply adds to the effects of regulation (and possibly a bank levy).

The cumulative impact of the FAT with regulatory changes on the main macroeconomic variables has been simulated to be -0.83% for GDP and -0.14% for employment in the long-run. At the sector's level, the impact is correspondingly estimated to be 0.12 percentage points for the cost of capital and 0.43 percentage points for the interest rate spread. This is also shown in Annex 10 where each of the instruments is considered (tax rate and regulatory requirement) to reinforce the marginal effect of the other on the cost of credit.

For a stylised STT, with the assumptions described in section 6.1.1 and Annex 15,[41] the cumulative impact with regulatory changes on the main macroeconomic variables has been simulated to be -2.23% for GDP and -0.30% for employment in the long-run for the baseline scenario. At the sector's level, the impact is correspondingly estimated to be 0.17 percentage points for the cost of capital. The cumulative effect cannot be directly integrated in the analysis as its impact depends on to what extent and at which frequency the actors are involved in the trading of the financial assets under the scope of the tax.

6.6. Conclusions

The aim of this chapter of the impact assessment was to analyse the consequences of the introduction of additional taxes (FTT and FAT) on the financial sector with regards to the objectives explained in detail in section 4. As each of the policy options achieves the various objectives with a different degree, the choice is essentially a trade-off. The analysis showed that both instruments – FTT and FAT – are in principle technically feasible, provided that the design and conditions of implementation take into account the identified risks and that taxes are introduced in a strict coordination framework at the EU-level.

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[41] With the caveat that the two underlying models are different.

Both taxes seem to have the potential for raising significant tax revenues from the financial sector. The FTT, however, is likely to be associated – when adopted in isolation - with a higher risk of delocalisation of transactions, especially with respect to frequent short-term transactions.

Both taxes are also expected to have small effects on GDP and employment, with the negative effects of the FTT probably being slightly higher than those of a FAT. The reason for this negative effect is the increase in the cost of capital, as the taxed persons will try to pass the tax through to their clients, and which then negatively interacts with investment. On the other hand, the FTT is more directly targeted towards reducing short-term trading which can create systemic risks. The FTT might be a better instrument to reduce this type of trading, as it would increase the costs of frequent short-term transactions (for instance automated and high frequency trade) much more than those for long-term investment transactions. The economic benefits of this are difficult to assess but may potentially be large as the recent crisis has revealed.

The distributional implications of a tax on the financial sector, be it a FTT or a FAT are typically progressive, i.e. such taxes fall more on the richer parts of society than on its poorer parts. This holds especially for the FTT on transactions with financial instruments such as bonds and shares and derivatives thereof.

However several elements need be taken into consideration to mitigate the risks of relocation when a FTT would be implemented at EU level. These include the definition of a harmonised tax base that shall be as broad as possible, low rates differentiated by products to promote virtuous behaviours, a monitoring that rely on the implementation of foreseen regulatory changes in the sector, a tax collection based directly on the books of financial institutions, the set-up of anti-avoidance measures, a legal incidence targeted to financial institutions, and a particular attention to the cumulative impact with regulatory reforms.

Essentially, the choice of taxation instrument is a trade off depending on criteria and objectives chosen. Since the final objective of the Commission FTT proposal is to reach a global agreement on taxation of the financial sector, the political and economic value of being a first mover is considered important. In the event of other regions following the European example, the economic benefits of the EU FTT would surely increase as the risks of delocalisation diminish.

Hence, the Commission decision[42] to put forward a legislative proposal on a FTT must be seen not only on the basis of its isolated economic merits but also in terms of the global context and the potential for influencing international developments, as well as on its aspects of providing a new sources of European revenue, which may be tapped into by Member States as well as by EU's own resources.

7. ANALYSIS OF IMPACTS OF DIFFERENT VARIANTS OF A FTT ACCORDING DESIGN

This chapter looks into key choices to be made, when designing a common system of FTT in the European Union. This namely holds for:

- The products and transactions to be covered

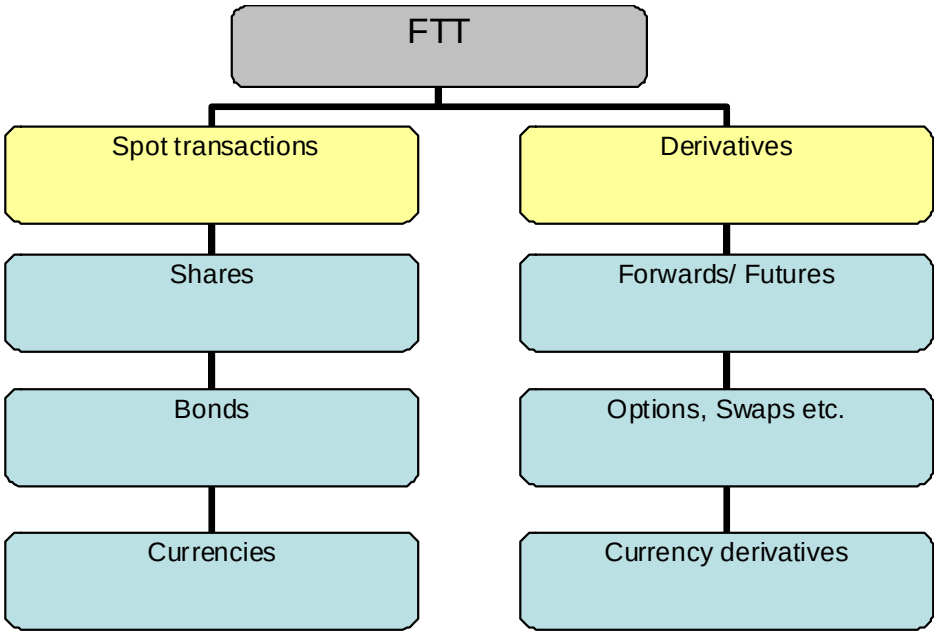
[42] References to the June Commission communication on MFF

- The definition of the taxable event that triggers taxation
- The regional coverage and the place of taxation
- The taxable base/amount
- The tax rate
- Provisions for avoiding abuse and evasion

7.1. Products and transactions covered

The different types of FTT are most often distinguished based on the products that are subject to the tax. Figure (1) below outlines the different financial products that may be subject to a FTT.

Figure (1) :Products suitable for a FTT



Typically one distinguishes along different dimensions, such as

- primary markets (where e.g. securities are issued) versus secondary markets (where securities are traded),
- spot markets (e.g. for currencies, securities, commodities) versus derivatives markets (e.g. for currencies, securities, commodities, risks, interest rates), or
- trading on regulated exchange markets versus trading "over the counter" (either with clearing houses or without).
- The following policy options distinguish between a tax on (i) currency spot and derivatives transactions, a tax on (ii) securities transaction on primary and on secondary markets, and a tax on (iii) derivatives markets, excluding derivatives on currency exchanges, (i.e. including derivatives markets for all other financial

products, such as derivatives based on securities, commodities, risks, interest rates, including on indices thereof).

All markets covered are both regulated exchange markets and trading "over the counter".

7.1.1. Option 1A: Currency transaction tax (CTT)

The basic idea of the CTT is to levy a tax on currency transactions and related instruments (FX forwards and FX swaps) transactions. The collection would take place centrally at currency exchange systems, namely in Real Time Gross Settlement (RTGS). Therefore, transactions can be settled with immediate finality. 'Gross settlement' means that each transfer is settled individually rather than on a net basis. For transactions which are tracked in such systems, a tax could be levied centrally. Note that this option poses considerable legal issues, which are explained in Annex 7. We can therefore distinguish between spot currency markets and derivative markets for currencies.

7.1.2. Option 1B: Securities transaction tax (STT) without derivatives and currency transactions

The STT without derivative and currency transactions corresponds to the narrow-based transaction tax described in the SWD on financial sector taxation, which would tax only the spot transactions of equities and bonds (on primary and secondary markets). It would be levied on all bonds and stock transactions executed in regulated markets thereby making the technical implementation cheap and easy since these systems are operated with centralized economic systems. This option is similar to the UK stamp duty when combined with the domestic issuance principle. Alternatively, one could exclude primary markets, so as to avoid making such capital-raising more expensive. Then such a securities transaction tax would only be levied on the trading of shares and bonds on secondary markets.

7.1.3. Option 1C: Financial tax on derivatives

Such tax would cover all financial derivatives that are directly (such as options or futures) or indirectly (such as interest or credit default swaps, or options or futures on indices) derived from products traded on regulated exchanges or traded over the counter. This can include financial derivatives for currency transactions securities or commodity based derivatives, risk or interest rates based or all other financial derivatives that are not outright spot transactions and transactions for the raising of capital, such as bonds and shares.

7.1.4. Option 1D: Financial transaction tax

This option would cover all financial transactions as outlined above or a subset thereof. Such subset could e.g. exclude taxing outright spot transactions on currency markets (so as not to come in conflict with Article 63 TFEU) and exclude taxing the raising of capital through the issuing of bonds or shares (so as to somewhat ring-fence the real economy and the public sector against negative direct cost implications):

Pros and cons of the different options

The fact that with the Section C of Annex 1 of the directive on markets in financial instruments (MiFiD) there already exists a well-established classification of financial instruments and products, this definition and the taxonomy is taken as a starting point for defining the scope of the FTT proposal with respect to products to be covered. Going for other

definitions would be relatively cumbersome and might jeopardize the overall policy objective of smart and simple regulation and might also trigger inconsistencies once it comes to applying both MiFiD and the FTT legislation.

Given the overall objective of raising significant revenues and limiting as much as possible the potential for substituting taxed and non-taxed products, all products that define financial markets and financial transactions and that could be close substitutes should form part of the basket of products covered. This would require covering both transactions on regulated markets and over-the counter transactions. It would also require taxing financial instruments such as shares and bonds as well as derivatives thereof. Going for narrower definitions would invite for large-scale tax-avoidance activities. Thus, an FTT covering all securities and all derivatives thereof seems to be the most suitable coverage of taxable products under an FTT.

As regards currency transactions, and while taxing them could generate significant additional revenue, there might be a potential conflict between the objective of raising additional revenue and the objective not to impose restrictions to the free movement of capital. This holds especially for spot currency transactions as there is hardly any international trade in goods and services or direct or financial investment across different currency zones that could take place without exchanging one currency for the other, either immediately or at a later stage. Especially taxing currency transactions involving different EU currencies is typically assumed being in violation of Article 63 TFEU, while taxing currency transactions involving non-EU currencies could potentially be made compatible in case the Council decided to do so in applying Article 64.3 TFEU that enables it. However, activating Article 64.3 would definitely be interpreted by third countries as a protectionist measure, and the benefits of generating additional revenue must be weighed against the drawbacks for globalisation.

In consequence, the most promising option with respect to achieving the objectives for defining the scope of the FTT seems to be to cover the products enumerated in Section C of Annex 1 of MiFiD, including currency derivatives. The verdict on also including currency spot transactions remains open.

7.2. Taxable event

For an FTT, the taxable event could either be based on the accrual principle, i.e. when the transfer of ownership takes place or a contract enters into force, the cash principle, i.e. when the actual payment is taking place, or a hybrid of both concepts.

For some transactions such a distinction could be rather irrelevant as both occur at the same time, especially when transactions are carried out electronically. This is typically the case in financial markets. However, in case one opted for a cash-based approach only, there might be an incentive for deferring payments so as to benefit from substantial cash-flow advantages. The basic concept of defining the transfer of ownership of a financial instrument or the registration of a contract in case of OTC derivatives or the sale and purchase of a product for the taxable event of a transactions tax has the advantage of minimizing this risk. Also in cases where no exchange of instruments takes place, the taxable event would still occur, i.e. when the contract is concluded while the chargeable event is at the point where the legal obligations occur. For derivatives, the taxable event would then typically be the moment when the contract is agreed upon. So, the concept followed is a hybrid of the cash and accrual based principles.

Also, a decision needs to be made in how far all transactions relating to securities should be taxed, i.e. both their issuing and their trading, or whether one wants to exempt the issuing of securities. Two arguments are advocating for not taxing the issuance, a legal one and an economic one. As regards the first, reference must be made to the Capital Raising Directive, which does not allow for additional taxes on the raising of capital through the issuing of shares or bonds. Also from an economic point of view directly taxing the raising of capital might unduly hamper economic growth and the development in the non-financial sector, as it would make the financing of investment more expensive for the non-financial part of the economy. In addition, primary markets are estimated to account for about 3.5% of spot equity transactions and 1.6% of spot bond transactions, hence generating about 0.3 bn extra revenue at a rate of 0.1%. Thus, excluding the issuing of shares and (government and corporate bonds) might be preferable in the overall context.

However, as regards derivatives, and in the light of the large variety of financial instruments, their characteristics and remuneration conditions appear to favour an approach where in the case of derivatives both primary (contracting/issuing) as well as secondary (trading) market financial transactions should be subject to the tax.

7.3. Place of taxation

In order to define the financial transactions that each jurisdiction would be entitled to tax under the FTT, different principles could be used. More particularly, the right to tax could be defined by reference to (a) the tax residence of the parties involved in the financial transaction; (b) the place where the financial transaction is deemed to have taken place; or (c) the place of issuance of the financial instrument being traded. Those approaches have different challenges with regard to tax collection mechanisms, enforcement and revenue distribution. A more detailed explanation of each of these principles and comments on their advantages and disadvantages is provided in Annex 7 and invite for the conclusion that the residence principle is superior, especially when it is about taxing transactions that can often rather easily be globally relocated. In particular, the issuance principle is not very suited to derivatives as it entails high relocation risks.

7.4. Taxpayer

The FTT could be levied either on the parties to a transactions, be they financial institutions or not, or on the financial institutions being party or intervening on behalf of a party. If the FTT was levied on the parties themselves, this would also include non-financial enterprises undertaking financial investment and/or hedging the financial risks linked to their own business, and private households investing in financial products such as shares, bonds or derivatives such as options. Going for this option would not exclude obliging the financial institutions involved to actually withhold the tax and pay it. However, the political dynamics of the signal that the tax once again would not be a tax on the financial sector but one on non-financial companies and private households would have to be addressed. This could be done e.g. by recalling the fact that presently about 85% of all financial transactions foreseen to be taxed would be transactions between parties within the financial sector only. However, in case market dynamics changed, including through the raising of an FTT, the share of non-financial sector transactions might significantly increase.

Alternatively, one could levy the tax on financial institutions only. This would have the advantage of targeting the legal incidence on the financial sector and of avoiding the

problematic of potentially high administrative costs of a FTT on non-financial actors. Defining "financial institutions" in the broadest possible sense would then be a prerequisite for both covering most transactions and for not opening the door for creative circumvention efforts. A starting point for a broad coverage could once again be MiFiD, and section C of Annex 1 thereof. The financial sector would then include banks, credit card companies, insurance companies, consumer finance companies, management fund companies, stock brokerages, investment funds, hedge funds and some government sponsored enterprises, regardless of whether these entities are or not subject to Corporate Income Tax in their respective Member State of residence. In order to catch also intra-group financing and shadow-banking activities, all the enterprises conducting more than a certain threshold of financial activities should become subject to the FTT too.

So as to avoid tax avoidance by switching to non-EU financial institutions the option of also making them liable to pay the tax due in case they were involved in transactions with EU parties could be considered. However, the issue of extraterritoriality and pursuing such an approach would first deserve further analysis, including checking its compatibility with other EU policies. An alternative to this approach would be to require the EU party to a taxable financial transaction to also pay for the non-EU party. While this would lead to an equal tax burden for equal transactions, independent of whether both or only one of the parties was established in the EU, it might put the EU party at a disadvantage as compared to EU competitors engaging with another EU party. However, depending on the market conditions, the EU party having to pay for both legs of the transaction could try to recover the additional tax from its counterparty.

7.5. Taxable base

The definition of the taxable base for spot transactions should not pose serious problems. There is a large amount of national experience and the value of the asset as priced in the transaction could be taken as the taxable amount. The gross transaction volume would be the tax base.

Although some derivatives do have their own value at the moment of contracting, for many other derivatives the only readily available reference value, which could serve as a taxable base is the value of the underlying instrument or asset. Nevertheless, levying the FTT on the notional values has certain disadvantages too: (i) it does not reflect the value of the derivative, its risk profile or its economic substance; (ii) it may be a disproportionate tax base compared to the value of the derivative, especially when the derivative is used for hedging; (iii) it poses specific problems with regard to structured products; (iv) collection by withholding at the taxable event may not be possible due to lack of a monetary flow at the moment of contracting. Those issues are dealt with in more detail in Annex 7. On the other hand, trying to find a proxy for the market value in case of derivatives where no cash payment is agreed at the outset, e.g. with the help of marked-to-market or model-to-market approaches seems to be administratively very cumbersome, and it risks of inviting for arbitrary decisions and a lack of harmonised implementation at the level of tax authorities. Also, often derivatives such as contracts for difference do not really aim at hedging risks. Instead such constructs try to simply minimize the injection of capital as compared to directly investing in the underlying and – through this leverage – generate much higher rates of return (on the capital invested). Only taxing the economic value of such a transaction would put directly investing in the underlying at a significant disadvantage. While this unequal treatment of more or less equal assets underlying a transaction could be avoided by applying different tax rates, simply taking

the same tax base, i.e. the market value of the underlying would avoid defining a multitude of different tax rates so as to accommodate for the creativity of market actors.

Options retained are using (i) the gross transaction value for spot transactions, and (ii) the value of the asset underlying a derivative contract (i.e. notional value). It shall be however noted that rates can be adapted to the base so that revenues generated and the tax burden on a specific transaction could be identical regardless of the chosen definition of the base.

7.6. Tax rate

With regard to the structure of the tax rate, two options are possible: a flat rate and differentiated rates. A flat rate would have the advantage of ease of application, but it will disregard the relatively much higher effective tax burden when the tax base is high (e.g. when the tax base is the notional amount of derivatives). The actual tax rate and whether it would be fixed or differentiated depends on the relative importance of the policy considerations outlined above, namely the revenue potential and curbing undesirable market behaviour.

Most recent proposals assume a low flat statutory tax rate, which ranges between 0.01% and 0.1%. By contrast, some Member States have experience in applying stamp duties on equities amounting to 0.5%, and even 1.5% to address tax avoidance. Note that these duties do in general not include derivatives in its scope. A relatively low level of taxation is likely to be essential to avoid strong negative impacts on markets and to ensure some revenue collection, since the incentives for avoidance increase with the tax rate.

7.7. Conclusions on the design

For an efficient application of any version of an FTT an agreement on the scope of the tax, tax rates as well as on the precise tax bases and other essential features of the tax is highly advisable. Firstly, there are strong economic reasons for a high degree of harmonisation and co-ordination in order to avoid substitution and loopholes. Secondly, there are technical arguments. Some national exchanges have merged in recent years and use the same technical infrastructure, e.g. NYSE Euronext (Amsterdam, Brussels, Lisbon, and Paris), OMX Nordic Exchange (Nordic and Baltic countries and also third countries like Iceland) and most notably EUREX (Germany and Switzerland). These systems are highly integrated and co-ordination of tax administration and enforcement between the countries is advisable. Again, applying the residence principle as outlined above could mitigate these issues. Therefore the preferred option for a harmonised FTT is a tax on the issuance and trading financial transactions by financial institutions and covering shares, bonds and related derivatives – at notional value – with a maximum tax rate of 0.1% for stocks and bonds and 0.01% for related derivatives based on the residence principle. The inclusion of spot currency transactions is subject to its legal feasibility as explained in Annex 7.

For illustrative purposes and in line with the estimates in Annex 11, we operate under the working assumptions[43] that spot securities transactions (STT) would be taxed at 0.1% with an elasticity of -1, that transactions of derivatives would be taxed on the notional at 0.01% with a decrease in transactions volume of 70% and an elasticity of 1.5, that transactions of spot currencies would not be taxed, and that transactions between financial institutions represent 85% of total transactions, this document estimates a potential revenue of about EUR 37

[43] These assumptions follow the illustrative rates depicted in European Commission. SEC(2011)876final (page 25) and do not pre-empt the rates that would be chosen in a possible proposal.

billion.[44] Exempting primary securities markets would reduce this amount by EUR 0.4 billion.[45]

Table (5). Illustrative revenue potential per category of products

Segment	Revenue potential (EUR bn)
Equity spot	5.6
bonds spot	10.4
Exchange interest rate derivatives	12.5
Exchange equity-linked derivatives	0.9
OTC Interest rate derivatives	9.2
Currency Swap	4.0
Currency outright forward	1.0

Note: See assumptions hereabove in the text.
The estimates are for the total market. The total is EUR 43.6 billion. 85% of this amount brings the EUR 37 billion mentioned above.

7.8. Impact of FTT

7.8.1. Impact on capital costs

The effects of transaction taxes on the cost of capital (and thus firms' investment behaviour) have been investigated particularly for the case of securities. A general theoretical result is that higher transactions costs, including those imposed by transaction taxes, are associated with lower asset prices (Kupiecs, 1996). Investors facing higher costs to acquire a security require a higher return from holding it, and thus will try to bid the price down. If successful, this may increase the cost of capital faced by those firms issuing securities, which in turn could then translate into lower investment at the macroeconomic level. The effects on the security prices and on the cost of capital increase in the tax rate and are dampened with longer holding periods[46].

Empirical studies of the impact of STTs on financial markets generally confirm the theoretical result that they increase the cost of capital and reduce asset prices, particularly for shares with high turnover rates[47]. By raising transactions costs, STTs would also increase the average holding period of securities, particularly for securities with initially narrow bid-ask spreads. In turn, this would reduce the impact of the tax on securities values and capital costs. As corporate bonds are generally traded less frequently than stocks, a given STT would likely impact corporate borrowing costs less heavily than stocks. This could create incentives to seek financing via credit from either financial institutions or corporate affiliates[48]. The

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44 85% of (EUR 16 bn on STT equity and bonds + EUR 9.2 bn on OTC interest rate derivatives + EUR 13.4 bn on exchanges derivatives + EUR 5 billion on currency derivatives).

45 If the hypothesis is a relocation of 90% for derivatives, then revenues would be 85% of (EUR 16 bn on STT equity and bonds + EUR 3.1 bn on OTC interest rate derivatives + EUR 4.5 bn on exchanges derivatives + EUR 1.6 billion on currency derivatives), that is EUR 21.4 billion.

46 Matheson (2011) calculates that a 10 basis point STT would increase the cost of capital by 0.4 percentage points for an average holding period of 3 months, whereas the effect is reduced to 0.01 pp for a 10-year holding period (see Table 9.1 in Annex 10).

47 Umlauf (1993), Hu (1998), Bond, Hawkins and Klemm (2005), Schwert and Seguin (1993), Oxera (2007).

48 These affiliates will in turn have to finance this loan via other channels. The FTT could be avoided if those affiliates are located in a country that does not apply the tax.

consequence would be an increase in leverage.[49] It shall be mentioned however that the FTT would have an indirect effect on the interest rate and the volume of loans so that it softens the relative advantage of bonds.

These effects could be reduced if primary (i.e. issuance) markets are exempted. The actual impact depends then on whether shares and bonds are traded on the secondary market and, in such case, to which extent taxation on the secondary market is priced-in on the primary market.

7.8.2. Budgetary impacts

Before presenting some rough revenue estimates, a general remark on the quality of tax revenue estimates for new tax instruments should be made. Estimating revenue changes when reforming existing taxes is already a difficult task since behavioural changes due to tax rate or base changes are often difficult to predict. Estimating revenue for taxes that would be newly introduced and that – at least to a certain extent – have the goal to change market behaviour and structure is not feasible without a high degree of uncertainty. This comprises also the effects on other taxes like CIT, capital gains taxes which revenue could decrease when introducing additional taxes. These effects are not considered here. Moreover, notwithstanding the often substantial projected receipts, the consequences of governments increasing their reliance on this relatively volatile sector for their revenues should be considered carefully.

Note also that in both cases the collection of these revenues comes at a cost in terms of a decrease in GDP decrease, which influences the tax revenue generated by other taxes. See Annex 15 for more details on the GDP effects of tax measures.

For a detailed description of the databases, the methodology, the different scenarios as well as the caveats see Annex 11.[50]

Policy Option 1A: CTT

A currency transaction tax on spot transactions and currency derivatives levied at a tax rate of 0.1% and assuming and elasticity of -1 for spot transactions and -1.5 for derivatives would lead to hypothetical tax revenues of around EUR 21.2 billion (0.17% of GDP) using 2010 figures (scenario 1), of which EUR 18.8 billion would be generated by taxing spot currency transactions. Using the assumption that trade volumes in derivative markets reduce by only 70% the revenue is estimated to be EUR 26 billion (0.21% of GDP). In both scenarios the relocation and evasion of spot market transactions is assumed to be 40%. In the case of a tax rate of 0.01% the revenue estimates are EUR 8.5 billion (0.07% of GDP) in scenario 1 (of which EUR 6.9 billion would be generated by spot currency transactions) and EUR 12 billion

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[49] A priori, SMEs would be put at disadvantage because small and medium size companies may have more difficulties to access credit from financial institutions or affiliates (many SMEs are stand-alone companies) because of information asymmetry on the actual economic situation, of a lack of reputation and a lack of collateral against which to borrow. Beck, T.; Demirgüç-Kunt, A. and Maksimovic, V. (2005).

[50] Note that the scenarios here are for a broad scope of the FTT. Annex 11 provides more information on smaller scope. In particular, transactions between financial institutions are assumed to represent 85% of the total. Primary market for bonds and equity are assumed to be respectively 1.6% and 3.3% of their secondary market. It also provides data on the gross market value of derivative contracts (around 3 to 3.5%) in comparison with the notional value used for these estimates.

(0.1% of GDP) in scenario 2. It should be noted that this option raises significant legal issues as explained in Annex 7.

Policy Option 1B: STT

Levying a tax on stock and bond transaction in regulated exchanges at a rate of 0.1% would lead to revenues of around EUR 16 billion (0.13% of GDP) assuming that evasion and relocation reduce the tax base by 10% and that the elasticity is -1. It splits in EUR 5.6 billion for stocks and EUR 10.4 billion for bonds. If the tax rate is lowered to 0.01% revenue drops to less than EUR 2 billion (0.01% of GDP)

Policy Option 1C: Financial tax on derivatives

Assuming an elasticity of -1.5 for derivatives, levying a 0.01% tax on derivatives would raise about EUR 24 billion for non-currency derivatives and about EUR 5 billion for currency derivatives, for a total of about EUR 29 billion under scenario 2. Under scenario 1, non-currency derivatives would bring about EUR 8 billion and currency derivatives would bring about EUR 1.5 billion, for a total of about EUR 9.5 billion.

Policy Option 1D: FTT

Option 1C is simply the sum of revenues of option 1B and 1C. Note that the revenue estimates presented here differ from other studies mainly with regard to the assumptions of derivative markets. The reasoning behind the assumptions that these assumptions might be stronger than is widely assumed is set out in Annex 11. Under scenario 1, a 0.1% STT and 0.01% tax on all derivatives would raised combined about EUR 25 billion. Under scenario 2, it would collect about EUR 45 billion.

7.8.3. Relocation

The introduction of additional taxes bears the intrinsic risk of agents relocating their activities to reduce the fiscal burden. Relocation might take place by moving the relevant activities to jurisdictions where they are taxed less, or by shifting to products/suppliers outside the scope of taxation within the same jurisdiction. In principle, this might even lead some products/markets to disappear in the medium and longer run. Obviously, the risk of physical relocation of markets/market players and migration to non-taxed products increases the less widespread is the adoption of the taxes and the narrower their scope. Thus, the concrete design of a tax in combination with the transaction costs of relocation will largely impact on the actual extent of relocation. The cases of Sweden and the UK, which both introduced a tax on financial transactions with different relocation effects, provide some evidence for this (see Annex 5 for details).

Improved communications technology and financial innovation makes FTT particularly prone to the risks of relocation, especially in the case of unilateral introduction. Annex 9 reviews the existing evidence on the effects of FTTs on financial transactions. The responsiveness of traded volumes to taxes (and transaction costs in general) varies across products and markets, as it is heavily influenced by available substitution possibilities and the characteristics of the relevant trading platforms. Thus, the design of the tax will be as important as its rate or change in the rate.

Economists often use "elasticities", i.e. by how much does a variable (e.g. demand) change when it is exposed to a change in another variable (e.g. the price) by one percentage point

when they want to predict market reactions to changes in parameters such as taxes, wages or prices. When using tax elasticities, only the percentage change in the tax rate is looked at, while the corresponding change in the price (including taxes) of the product is considered irrelevant. This also holds for so-called "semi-elasticities" that do not measure the tax change in percent but in percentage points instead. Semi elasticities are typically used, when the absolute level of a tax is very low, as using ordinary elasticities in such a case might lead to implausible results.

For instance, estimated elasticities on spot markets are on average 0.9% for equity, and 0.5% for foreign exchange transactions (i.e. an increase in the tax by one percent, e.g. from 0.500% to 0.505%, would decrease the tax base for equity by 0.9% and the tax base for foreign exchange transactions by 0.5%). Transactions on future markets tend to react more strongly to taxes: average estimated elasticities are around 1.1% in the case of equity and 1.7% for foreign exchange transactions. Moreover, long term elasticities seem to be larger than short term elasticities, potentially reflecting the time lags necessary to develop substitution alternatives for the taxed financial instruments. This suggests that the level of revenues obtained in the short run might not be sustained in the longer term. All in all, the analysis concludes that the tax should be levied on products with few substitution alternatives, that the elasticity estimates may be very region-specific and should be extrapolated with caution, that long-run elasticities seem larger than short-run elasticities, that foreign-exchange transactions seem less elastic than equity transactions, that elasticities of futures (on exchange) is larger than elasticity of spot trading. In addition it shows that a tax on interest rate derivatives would target the largest tax base, that high profit margin markets are less elastic than low profit margin markets, that long term trading seem less elastic than short-term trading and that elasticities are expected to change over time.

As the level of financial transaction taxes is often very low, looking at the semi elasticities provides a more precise picture of their effect on the taxable base. According to the findings reviewed in Annex 9 a tax increase of 1 basis point has triggered reductions in traded volumes ranging from 0.5-4% on equity transactions to 28-85% on fixed income securities. The latter figures are derived from the Swedish experience (see Annex 8), which can be considered a paradigmatic example of the staggering market effects of increased transaction costs when avoidance and relocation are easy and cheap.

The risks of relocation, as well as those arising from potential migration towards untaxed substitute products, could be minimised by extending the geographical coverage of the tax and by including a wide range of financial products and markets (exchange and over-the-counter) in its scope. It can also be reduced by linking the FTT with some form of registration. Clearly, coordination in terms of products covered by the tax as well as of applicable tax rates is a prerequisite for lowering the incentives to relocation across jurisdictions. Furthermore, tax rates could be differentiated on the grounds of both products mobility and other characteristics of the relevant exchanges. For instance, transaction costs might have disruptive impacts by hitting disproportionately profitability in those markets where current margins are very thin. The flip side of the coin is of course an increase in the costs of administering the tax and a reduction in potential revenues.

To the extent that financial transactions are more mobile than financial companies, taxing institutions that carry trade on the basis of the residence principle could mitigate relocation risks compared to taxing transactions at source or at the place of issuance. For example, under the residence principle, a financial company located in a country that applies the FTT would

be taxed on its operations irrespective of where these transactions take place (if applied on a worldwide basis).[51]

Against this background, it is difficult to make unequivocal conclusions on the exact size of the elasticities and relocation risks (although there are strong risks of relocation). Our revenue simulations consider a relocation of securities markets by 10%, a relocation of spot currencies by 40% and a relocation of derivatives instruments of 70% or 90% (see annex 11 and section 6.1.1). 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. To the extent that High-Frequency Trading is considered as harmful, one has to bear in mind it is estimated to be about 40% of total transactions.

7.8.4. Macroeconomic impacts

The use of Dynamic Stochastic General Equilibrium (DSGE) models is a standard procedure of estimating the macroeconomic effects of policy changes. Their advantage over sector-specific Partial Equilibrium Models is that they fully take into account spill-over effects to other sectors as well as second-round effects triggered by a policy change, including the effects of the recycling into the economy of higher tax revenues generated by a tax-policy "shock". One possible disadvantage is that they typically have less detailed sectoral breakdown of the economy than partial equilibrium models.

In such DSGE-models, simulating the effects of a new tax on a sector is typically made by simulating an increase in the corporate income tax, as such an increase would reduce the (after tax) rate of return of investment and, thus, would have a dampening effect on investment activities. This approach is acceptable when one assumes that the financial sector is similar to other corporate sectors, or that this sector is in any case able to pass through to its clients of the other sectors the higher costs/taxes. It should be noted, that in such models the corporate income tax is assumed to be the economically most distorting tax, as it has strong negative knock-on effects on investment and, consequently, on economic growth.

As an example, using the well-established QUEST-III model of the European Commission, and simulating an increase in the corporate income tax in the order of 0.15% (≈ €18bn) to 0.75% (≈ €90bn) of GDP respectively, results in a (downward) deviation of GDP from its baseline to be around 0.1% to 0.6% after 20 years. In this scenario, fiscal consolidation is supposed to be the primary way of revenue use.[52]

In its effort to assess the macroeconomic impacts of a financial transaction tax specifically, the Commission services have therefore developed a new dynamic stochastic general equilibrium (DSGE) model for that purpose (see Annex 15). This model is an attempt to simulate the effects of a specific subset of a financial transaction tax, i.e. a tax on securities (STT), and, whereas it has the merit to exist, it still has a number of limitations which should be taken into account when interpreting the results: it is a two-period and closed-economy

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[51] There is however still a risk that financial companies open foreign subsidiaries in countries that do not apply the tax and do the trading from these places. The profit made on these transactions could then be repatriated to the parent in the form of dividends.

[52] For details see European Commission (2010): Autumn 2010 forecast.

model that can not capture relocation effects, neither does it allow for an analysis of the incidence nor of differentiated effects across sectors.[53]

In contrast to existing models, this new DSGE model offers the novelty to emphasise the macroeconomic effects the tax could have and captures some of the endogenous channels via which the effects of the tax could emerge. Note also that this model does not only look at the cost of levying the tax in terms of GDP but also at the effect on volatility in the economy by assuming that uninformed traders (noise traders) are active in the stock market. These traders do not consider the economic fundamentals in their investment decision and therefore can distort market functioning[54].

Specifically, the model assumes, *inter alia*, that all private investment is financed by securities and that the financial sector only trades these securities, and that the STT is paid by traders to the government and then transferred to the household sector in form of a lump sum payment. In terms of channels, the STT decreases share prices which leads to higher financing costs for companies. This is the main effect in this model, which impacts then on investment, GDP and other macroeconomic variables, while initially higher consumption of private households triggered by the lump-sum transfers received can not compensate for this.

The model can be calibrated either to raise a defined amount of tax revenues (in which case, the tax rate adjusts to reach the target tax revenue) or it can set a defined tax rate (in which case, the tax revenues will be determined by the model). Different scenarios are presented in Annex 15. Here the focus is on the case of the introduction of 0.1% tax rate on securities transactions.

With a tax rate of 0.1% the model shows drops in GDP (-1.76%) in the long-run. It should be noted that these strong results are related to the fact that the tax is cumulative and cascading which leads to rather strong economic reactions in the model. Within the environment of the model the rate of 0.1% would translate into tax revenues of 0.08% of GDP or about EUR 9.8 billion considering EU-27 2010 GDP.[55] This revenue is in roughly the same range as the

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53 To consider some of these additional elements, Chisari, Estache and Nicodème (2011) develop a Computable General Equilibrium Model to assess the impact of imposing a VAT or tax on intermediate and final sales of the financial sector. Two scenarios of international mobility are proposed and compared: a closed-economy scenario for which capital is immobile internationally, and a scenario of mild capital international mobility. In the closed-economy scenario, the FTT is seen to be mildly progressive and almost all sectors of the economy suffer in about the same way. The international mobility amplifies the effects of the FTT, which almost triple. The fiscal effects are negative in the short-run as capital escapes. The progressivity of the tax is by and large maintained. The impact on the sectors changes depending on their degree of openness. The financial sector is however hit severely in both the short and long-run.

54 In the model, this is included by the fact that noise traders deviate from rational expectations based on economic fundamentals via 'noise' shocks. Traders borrow on the risk-free credit market and invest into risky assets.

55 A sensitivity analysis is carried out. First, one additional simulation is done as to raise 0.16% of GDP, which corresponds to what some studies have found when applying a 0.1% tax on securities. Given endogenous effects in the DSGE model, the tax rate that is necessary to achieve this fiscal result is 0.2%. In that case, GDP losses increase to -3.43%. Keeping this rate of 0.2%, a sensitivity analysis is carried out by changing the proportion of noise traders from 50% to respectively 25% and 75%. Such change does not affect the outcome of the main economic variables but marginally affects their volatility. The volatility of GDP measured as the ratio of standard deviation to the mean in percentage point goes from 0.03 to 0.02 and 0.07 respectively. Finally, a last sensitivity analysis is done by decreasing the tax rate to 0.01%. The GDP losses are then limited to -0.17% but revenues are decreased to 0.01% if GDP. All results are available in more details in annex 15.

revenue estimates for taxing equity trading only in the years 2005 to 2008 as presented in Annex 11 using BIS data

As this new model makes a series of stylized assumptions, for instance about the functioning of financial markets, the financing of business etc., its numerical results have to interpreted with some caution; they present tendencies rather than precise values.

Box. Estimating the effects of the mitigating elements

This Impact Assessment Report attempts to assess the macroeconomic impact of a Financial Transactions Tax. For that purpose, the Commission services have developed a dynamic stochastic general equilibrium (DSGE) model to qualitatively assess the consequences of the introduction of a Securities Transaction Tax (STT) in an economy. The model, described in Annex 15 of the Impact Assessment Report, is a first attempt to encompass some of the endogenous channels through which such effects could emerge. It shall be stressed that the current modelling is limited to a tax on securities, therefore excluding the derivatives markets. The baseline scenario shows that a 10 basis points (i.e. 0.1%) tax on securities trading leads to a decrease of GDP in the long run by 1.76%. This effect is mainly triggered by a decrease in investment. In such scenario, the revenue collection is 0.08% of GDP, a figure that is close to the findings in Annex 11 on the revenue potential of FTT.

In its proposal, the European Commission tries to come with a design of the tax that aims at closing as many loopholes as possible. In particular, the tax would be designed as to:

(a) Mitigate relocation effects by applying the residence principle.

(b) Exclude primary markets for stocks and bonds as to try to ring-fence the effects of the tax on the financing of companies.

(c) Target transactions that involve financial institutions and exempting from the tax those that do not involve such institutions.

(d) There is no doubt that many transactions may not be economically viable under a transaction tax. This is probably the case of High-Frequency Trading.

(e) Try to ring-fence some sources of financing for companies by excluding them from the proposal (bank lending, retained earnings). In such case, they would not be directly impacted by the tax (although they may be subject to indirect effects).

These features of the tax are not necessarily well taken into account in the modelling of the macroeconomic effects and the impact of this specific design on the macroeconomic effects is therefore of interest. There is no available model to assess these effects and the channels through which they impact macroeconomic variables. The only available approach is therefore to proxy the effects, at the cost of scientific rigour and with the large caveats and uncertainties that such an exercise may carry.

For this purpose, the following elements could be taken into account:

(a) The relocation aspects are already factored in. This is because the model is a close-economy model that does not allow for relocation of transactions. Hence, the model is already optimistic on these effects.

(b) Primary markets for stocks and bonds are a small fraction of the total amount traded. For the purpose of the impact assessment, the primary market for securities is proxied to be about 2.2% of the total. As a first approximation, excluding primary markets could in the best case decrease the effects of the tax by 2.2%.

(c) Transactions done by financial institutions have been proxied in this impact assessment to represent 85% of all transactions. Therefore, as a first approximation, taxing transactions involving financial institutions only could in the best case decrease the effects of the tax by 15%.

(d) High-frequency trading could be up to 40% of the total on some market segments. Provided we assume that the model would actually include the full effects of a FTT on markets, while the disappearance of high-frequency trading would be at no cost, the 'real' effects could be estimated to be 40% lower.

(e) The sources of financing of companies are generally assumed to be new equity (10%), retained earnings (55%), and debt (35%).[56] The share of debt securities in total debt of non-financial corporations could be estimated at about 15% (or about 5% of total financing)[57]. Hence, assuming bank debt and retained earnings are ring-fenced, the share of corporate financing that would be directly affected by the FTT is about 15% of the total. If we assume that other sources of financing are affected by about 50%, and that the incentives for increased leverage do not generate additional adverse effects, the total impact would be about 60%.[58] Hence, in this theoretical scenario, the effects of the tax would be at best 40% lower thanks to ring-fencing.

Under the assumption that all these effects simply cumulate, the negative effect on GDP could be, in the best case scenario, decreased to about -0.53% (instead of -1.76%).

7.8.5. Risk-taking and behavioural effects

The aim is to analyse how various types of taxes provide right or wrong risk-taking incentive and produce desirable or undesirable behavioural effects in banks. The more a type of tax proves to be risk-based and therefore follow systemic risk, the more we can exclude that that tax introduces wrong behavioural risk-taking incentives. On the contrary, that tax might contribute to reduce excessive risk-taking.

There is however no available bank-level data on contribution to FTT. The aspects of dealing with risk and behavioural effects of the FTT relates to the possibility of the FTT to curb speculation, noise trading and technical trade, and to decrease markets' volatility. Many studies show that a FTT could aggravate volatility (because of a reduction in the number of transactions), creating more room for speculators. An extensive review of the economic literature overall concludes that the effects of the FTT on volatility is largely inconclusive and depends on market structure[59].

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[56] Standard assumptions for computing effective tax rates according to the Devereux-Griffith methodology.

[57] In 2009, loans from credit institutions to non-financial corporations represented EUR 5,786 billion in EU27 (ECB (2010), EU banking structure, September). In December 2009, the total amount outstanding of debt securities issued by corporate non-financial issuers was USD 1,234 billion or EUR 864 billion (at a rate of 0.7) (Table 12C and 12D of From BIS Quarterly Review June 2011, for the 19 EU MS listed).

[58] 15% + 50%*85%

[59] See e.g. Hemmelgarn and Nicodème (2010)

The simulations with a dynamic stochastic general equilibrium model presented in section 6.4.1 and Annex 15 show that a FTT impact on volatility would be very marginal. On the other hand, the FTT would serve as a tool to deal with the challenge of short-sighted profit-seeking behaviour. Also, it would help to reduce the rents of the financial sector generated by activities such as high-frequency automated trading.

7.8.6. Incidence and distributional impacts

While the formal incidence is either on those who have the legal obligation to pay the tax or (with indirect taxes) those to whom the taxes are destined to by the legislators, e.g. the consumers in the case of VAT, the concept of economic incidence refers to the person or groups who bear the economic burden of the tax. In the case of the FAT, the formal incidence is on the financial sector with the precise institutional scope depending on the design of the tax instruments (see the description of the policy options in Chapter 5). The formal incidence of the FTT is typically on the parties engaged in the transactions. More detailed information requires linking the taxable event to the liable entities. To this purpose, one would have to look at the trading activity of the different participants in the markets for the relevant financial products. Information available on this is scarce (see Annex 12), but suggests that non-financial actors directly participate in trading activities to some extent.[60]

As long as taxes induce behavioural reactions and changes in relative prices, the ultimate burden will differ from the formal incidence. Given these distributional implications, understanding economic tax incidence is crucial, particularly when taxes aim at generating contributions from certain income groups or industries, like is the case in the ongoing debate on the financial sector making a "fair and substantial" contribution to repay the cost of the crisis. In general, the extent to which taxes on the financial sector are likely to be partly of fully rolled over to the clients of financial institutions depends on the price elasticity of demand and supply, and on the general competitive conditions in the relevant markets where the taxpayer operates. Moreover, the pass through will be influenced by how widespread the adoption of the tax is. All in all, although the economic incidence of the tax instruments under analysis remains uncertain ex ante, part of the tax burden is likely to fall on the clients of financial institutions. The extent of the pass-through will most likely differ, not only across the different types of taxes, but also across the possible variants of the same tax instrument.

As far as the FTT is concerned, a large part of the burden would fall on direct and indirect owners of traded financial instruments.[61] Moreover, levying the tax on secondary markets generates cascading effects, which might have non-transparent consequences, and thus make incidence more complex. In fact, if business transactions are non exempt, the tax will be cascading through the production process and affect the price of non-financial products and services. Concerning the distributional impacts, like any taxes on capital income, the short run

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60 BIS data on global OTC markets for FX and IR products show that around 11-13% of daily average turnover is attributable to counterparties other than financial institutions (see Annex 12). Of course, the extent to which non financial investors are involved in direct trading depends on the characteristics of the products owned and of the markets where they are traded.

61 Annex 12 reports data on the ownership structure of traded shares in Europe (accounting for 90% of market capitalization in 2007). Among investors classified as domestic by the national exchanges (63% of the total), financial institutions account for 27% of market capitalization (22% are collective investment institutions, comprising pension funds, insurance companies, mutual funds and collective financial investment companies. Private non financial companies and organisations (including foundations and trusts) own 17% of the market value of listed shares in Europe, while the aggregate share owned by households and individual investors is in the range of 14%.

effects of the FTT would likely be progressive, impacting particularly on households in the highest deciles of the income distribution, as these are typically the households that directly invest in taxed products. The evidence described in Annex 13 indeed suggests that these households are more likely to own riskier and more sophisticated financial products, and devote a higher fraction of their total expenditure to this category compared to low-income households.[62]

7.8.7. Effects on employment

The effects of FTT on employment can be twofold: directly on the financial sector and indirectly for the whole economy via the economic effects of the taxes.

The direct impacts on employment are triggered within the banking sector, in case the tax led (i) to delocalisation of activities outside the EU, (ii) to the abandonment of business models (such as high-frequency automated trading) no longer being profitable after tax, or (iii) to falling demand for financial services as a reaction to higher prices for these services in case of a pass through of the tax. This delocalisation risk and risk of abandoning certain activities would mainly hold for the FTT. However, given the extremely low employment intensity of such activities the negative employment effect should be limited, and presumably mainly be located in the investment banking arm of the sector, while the retail-banking arm should not be affected at all.

7.8.8. Impacts on market structures and competitiveness effects

Recent research based on experimental economics as well as some theoretical work points to the fact that the effects of a transaction tax depend on the market structure.[63] This structure differs between market segments and also between countries. If this structure is heterogeneous, the tax might affect the markets in question very differently. The empirical literature comes thus to different results when evaluating the effects of transaction taxes. While most studies find that trade volume is reduced, the effects on volatility and prices is less clear even though results based on panel data and estimation approaches that better identify transaction cost effects seem to find more often a positive relationship between transactions costs and volatility. For the discussion of the financial transaction tax in Europe one should keep in mind that the effects of the tax might be varying depending on the products traded and the way dealers and brokers interact in the national markets.

The impacts of the taxes on the competitiveness of the real economy (industry and services) depend to a large degree on the design of the tax. In case of the FTT, limiting the taxable products to financial instruments as defined in the directive on markets in financial instruments (MiFID), thus excluding everyday financial transactions (such as the payment of bills or of the salary) and transactions such as loans from banks to enterprises or private households (such as mortgage loans or the provision of consumer credits) goes in the direction of ring-fencing the real economy from the direct effects of levying this tax.

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62 Note also that concerns have been voiced about a possible undesirable consequence of a FTT that would include currency transactions as small developing countries may use larger currencies as mean of exchange between themselves as this market is more liquid (Yoder, S., 2011, presentation at the Brussels Tax Forum 2011, Brussels).

63 See Hanke et al. (2007) and Pelizzari and Westerhoff (2007). An overview of the literature can be found in McCulloch and Pacillo (2011) and Hemmelgarn and Nicodème (2010).

The implementation, compliance and administrative costs of taxes are typically not trivial, and in the context of e.g. VAT they are frequently the high on the agenda of stakeholders and tax administrations. Typically, these costs positively correlate (i) with the number and routine of actors, (ii) the heterogeneity of the tax base and the taxable events, and, thus, the complexity of the tax legislation and its implementation, (iii) the lack of standardisation and automatisation of reporting and tracking, and (iv) the expectation value of potential tax fraudsters not to be detected in the absence of checks and balances. The sector and activities o be taxed are characterized by a rather limited number of players, most of them being big companies, an extremely high degree of automatisation, standardisation and e-commerce in combination with a comprehensive reporting and tracking regime, the implementation, compliance and administrative costs of levying an FTT or an FAT should be rather limited. Indeed, empirical evidence from real cases analysed, such as the British stamp duty and reverse duty tax, or the Belgian or Suisse FTT show that these costs typically are at the bottom end of similar costs for the collection of other taxes.

8. MONITORING AND EVALUATION

The proposed policy intervention will exert effects on a number of variables that should be monitored. At the macroeconomic level, consistent with the general objectives of raising revenue from the financial sector and reducing undesirable market behaviour, evidence should be gathered on the revenue raised and the effects on short-term (automated) trading and its consequences on volatility and price deviations. In case of a unilateral introduction in the EU-27 the potential of relocation should be measured by comparing trade volumes for different product categories in the EU-27 vs. financial centres in third countries that are not operating under an FTT, taking into account any external factors.

At the microeconomic level, the effects of the policy options on financial institution's tax related administrative costs and on their investment and trading behaviour should be assessed. To overcome the well-known difficulties in obtaining reliable estimates of actual and perceived administrative costs, ad hoc surveys should be designed, and particular attention devoted to the representativeness of the selected samples.

The evaluation of the consequences of the application of the legislative measure could take place three years after the entry into force of the legislative measures implementing the Directive. The Commission could then submit to the European Parliament and the Council a report on the technical functioning of the Directive.

The content of such a report would vary according to the scope of the Directive as finally agreed in the Council.

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COMMISSION STAFF WORKING PAPER

IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

{COM(2011) 594 final}
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ANNEX 1

RESULTS OF THE PUBLIC CONSULTATION

1. PUBLIC CONSULTATION

The public consultation[1] was launched on 22 February 2011 and was closed on 19 April 2011. It was launched in order to receive stakeholder feedback on the initiative and in particular:

(a) to test the assumptions and collect related evidence as regards the definition of the problems;

(b) to assess the impact of the set of policy options; and

(c) to consult on more detailed aspects of the feasibility and design of the policy options.

2. SUBMISSIONS BY STAKEHOLDER GROUP

The public consultation generated considerable interest. More than 200 individual replies and a very large number of petitions were received. All individual responses to the public consultation are made public[2]. The feedback was divided into 6 stakeholder groups and subgroups listed below with the corresponding number of inputs[3]:

Registered financial organisations	
Banking	16
Financial markets/securities	10
Fund/asset management	5
Insurance	9
Financial sector in general	2
Mutuals	2
Real estate (with links to the financial sector, e.g. REITs)	1
Total	**45**

Registered non-financial organisations	
NGO	14
Trade unions	17
Industry/real sector/SMEs	8
Accounting/tax consultancy	5

[1] http://ec.europa.eu/taxation_customs/common/consultations/tax/2011_02_financial_sector_taxation_en.htm

[2] http://circa.europa.eu/Public/irc/taxud/consultation_taxation/library

[3] A large number of contributions were not filed in the correct dedicated email or directly to the general consultation email and had to be assigned to the respective stakeholder group at the processing stage under certain assumptions.

Real estate (general, i.e. not only those with links to the financial sector)	1
Total	**45**

Non-registered financial organisations	
Banking	12
Financial markets/securities	3
Fund/asset management	5
Insurance	1
Real estate (with links to the financial sector, e.g. REITs)	1
Total	**22**

Non-registered non-financial organisations	
NGO/ Research institute	31
Trade unions	17
Industry/real sector/SMEs	5
Accounting/tax consultancy	3
Real estate (general, i.e. not only those with links to the financial sector)	2
Parliamentary group/ Party	5
Total	**63**

Public authorities	
Central government/Ministry of Finance	4
Central banks	3
Regional authority	10
Total	**17**

Citizens	
Individual submissions	**21**
Petitions	**3411**[4]

Total individual submissions	**213**
Total submissions (including petitions)	**3624**

3. DETAILED POSITIONS OF STAKEHOLDERS

3.1. Registered and non-registered financial organisations

Taxation not an appropriate tool

[4] There are claims that many more such e-mails have been sent.

Besides the general opposition to any and all types of additional tax burden on the financial sector or financial markets, financial organisations argue that taxation is not an appropriate and sufficiently targeted tool to tackle behavioural issues (e.g. excessive risk taking) and that the cumulative impact of newly introduced or to be introduced regulatory measures would be detrimental to the financial sector and the economy as a whole. In particular, additional taxation would be contrary to the recapitalisation of banks and other financial institutions.

An additional argument is that if regulatory measures are geared towards the optimum level (e.g. desirable and acceptable leverage and/or risk), then tax measures would distort the policy impact towards a sub-optimal outcome.

Over-taxation

All replies essentially reject the argument for under-taxation of the financial sector. They argue that the VAT being an indirect tax is ultimately borne by consumers. Therefore, financial sector's individual clients, and not the financial sector itself, are the ones that benefit from the VAT exemption. The financial sector bears the tax burden from the non-deductibility of input VAT. With regard to the VAT exemption, some of the replies advocated for a solution involving the abolition of the exemption.

Additional taxes in certain Member States (e.g. insurance premium taxes and other parafiscal charges, bank levies, payroll and turnover taxes, limited deductibility of certain interest expenses or bad debt provisions) were highlighted in that respect by some respondents. Others argue that fair value taxation would tax (unrealised) gains in the upward section of an economic cycle, while the offsetting (carry back/forward) of the corresponding losses in the downward section of an economic cycle would generally be limited.

Some respondents opined that there must be an overall capping of all contributions through taxation and regulation in order to protect the capital base.

EU competitiveness and risk of relocation

The respondents advance arguments related to risks for the competitiveness of the EU financial sector and the risks of relocation (outside the EU and to unregulated non-transparent markets). Other risks identified include a tendency to take up higher risks to compensate for the additional tax burden. Referring to the origins of the financial crisis, it is also argued that in case of relocation of "risky" activities the "importing" of non-EU risk would still remain or become even stronger.

General tax principles

From their perspective, any new taxation would be contrary to fundamental tax principles as equal treatment, proportionality and ability to pay. Banks and other financial organisations being simply conduits would not be able to bear the tax burden of any new tax themselves. The tax burden would essentially be shifted to any of their stakeholders, i.e. shareholders, customers or employees.

EU right to act

Four national bank associations and three insurance representatives questioned the EU's right to act on this fiscal issue, based on the principle of subsidiarity. They highlight that the financial sector in their particular Member State had not benefitted at all from any public support and was not involved in the financial crisis like financial sectors from other Member States.

Scope of the measures

Specific industries within the financial sector like insurance, financial markets/securities, fund/asset managers and real estate investments reject common measures targeted towards the financial sector defined broadly. It was pointed out that the financial crisis did not originate in those sectors, they had fundamentally different business models and they have unduly suffered from it, while at the same time providing stability to the financial systems in Member States. Any such cross-subsidisation was considered highly distortive.

Banks on the other side advocate for measures encompassing the financial sector defined broadly. They argue that not all banks were in the origin of the crisis, did not engage in unduly risky activities, did not receive public support. Furthermore, those that have received such support have largely already repaid it to the Member States' budgets.

Importance of the financial sector

Some of the respondents stressed the key role of the financial sector for the development and the proper functioning of Member States' economies.

An argument advanced against the FTT stated that speculation facilitates the functioning of financial markets, provides liquidity, reduces volatility and improves price discovery and that even a very low-rate FTT would hurt those functions. Several respondents advocated for an exemption for liquidity providers, market makers/specialists, systemic internalisers and central counterparties. The similar argument that high frequency trading is not a risky activity was also voiced.

FTT or FAT

While the majority of respondents in that group would oppose both options, there were a few that would rather favour a rent-taxing or risk-taxing version of the FAT based on the corporate income tax base principles in each Member State compared to a FTT.

Double taxation

Almost all respondents, especially from the banking sector, posed issues of double taxation created by new unilaterally adopted measures by several Member States.

Other technical questions

A great part of respondents refused to reply to the technical questions, arguing that no opinion could be presented unless there is stronger justification for implementing any of the outlined options for taxing the financial sector or there is greater clarity with regard to the actual features of the measures being considered. In addition, replies to many technical questions varied widely across the respondents from this group. Nevertheless, the following can be highlighted as common points among the answers to the technical questions:

- Using the underlying as the FTT base for derivatives is disproportionate, because it does not reflect the value or the risk associated with the derivative.

- Hedging activities are perceived as unduly burdened by a FTT. Several contributions advocated for an exemption for hedging activities.

- Expected administrative costs are generally considered high for any of the options and their respective designs. Some respondents agreed that an exchange-based FTT would have comparatively low administrative costs, but argued that this would have an adverse effect on investment in transparent markets. Other respondents would rather favour a CIT-based rent/risk taxing FAT from administrative costs point of view.

- On the issue of alignment with VAT most respondents replied that such alignment would not be practical and that the VAT exemption must be addressed through amendments to the EU VAT rules.

3.2. Registered and non-registered non-financial organisations

The positions of the two major groups within that category differed diametrically.

a. Industry/real sector/SMEs, Accounting/tax consultancy, Real estate (general, i.e. not only those with links to the financial sector)

While the replies were largely not in favour of additional taxation on the financial sector, essentially employing the same issues and arguments brought forward by the financial sector respondents[5], the positions expressed were comparatively more moderate and detailed with regard to the technical part of the questionnaire.

SME and other industry representatives voiced against financial sector taxation fearing an increase to the cost of capital, investment, jobs, a decrease in the lending capacities of banks and a transfer of the tax burden to (corporate) clients.

Several industry representatives argued explicitly against an FTT (at EU or global level).

b. NGOs and trade unions

A substantial number of submissions were received from charitable organisations and other NGOs as well as trade unions.

FTT or FAT

NGOs and trade unions (registered and non-registered) are strongly in favour of a broad-based FTT levied at EU level (some submissions would accept also Eurozone level). NGOs are largely neutral towards a FAT as long as it does not "crowd out" the FTT implementation. Some trade unions, especially those from the financial sector[6] are clearly against an FAT, essentially considering it as a tax on labour.

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[5] E.g. EU right to act, tax principles, cumulative burden together with regulation, etc.

[6] Financial sector trade unions have been processed as part of non-financial organisations due to the fact that their submissions were sent to the non-financial sector dedicated mailbox.

Taxation an appropriate tool

All respondents of that subcategory accept taxation as a relevant policy tool. Various arguments were advanced, including contentions that the financial sector:does not benefit the real economy,

- gambles with the real economy performance and global GDP,
- performs socially useless activities,
- is generally under-taxed,
- enjoys an explicit public guarantee (privatisation of profits and socialisation of losses),
- benefitted substantial public support and
- poses systemic risk.

Another argument brought forward in favour of financial sector taxation relates to the broader discussion on approaches to addressing fiscal consolidation challenges. Other fiscal consolidation measures (e.g. reduction of public spending, increase of general direct and indirect taxation levels) are more socially costly as an alternative to the financial sector taxation and in particular the FTT.

Impact on employment and SMEs

The great majority of replies contended that an FTT would have a positive impact on employment and SMEs because it will have a stabilising effect on the markets and will drive capital out from speculation into the real sector. Others accepted a possible decrease in the employment levels in the financial sector, but claimed that this was a desirable effect.

Under-taxation

All replies from this respondent subgroup opined that the financial sector is under-taxed, mainly because of the VAT exemption of most financial services. Other arguments were the profound use of offshore structures and other techniques for tax planning and excessive leverage, driving effective tax rates down. The most cited subsectors were investment banking and alternative investment funds.

Scope of the measures

Some professional trade unions voiced against any tax burden being disproportionately put on traditional banking activities.

Tax incidence and cumulative effect

While admitting that the FTT will most probably be passed on to clients, most of the replies argued that the actual tax incidence will fall primarily on speculators and will not affect

regular investors. Any cumulative effect was desirable in order to curb speculative high-speed trading, while the notion of a cumulative tax is not in contradiction with any general tax principles, because there is no real value added at any stage of the trading of a financial instrument.

Other technical questions

Almost all respondents from that subgroup limited their comments to technical issues related solely to FTT. The common points in the answers to the technical questions of that subgroup are as follows:

- the taxable persons must be the contracting parties;
- the place of taxation must be the place of settlement (place of trading);
- the tax revenues must be transferred from the collecting agent at the place of settlement/trading to the Member States of the contracting parties;
- hedging by industrial companies is long-term business, is always related to a relevant underlying and will therefore not be strongly affected;
- central bank operations may be exempt;
- there may be a de-minimis rule operating through a refund mechanism;
- administrative costs were considered low.

3.3. Authorities

A comparatively much smaller number of replies were received by public authorities, especially by central authorities.

a. Central banks

All three Central banks that replied to the public consultation are clearly against either a FTT or FAT. One of the banks questioned the compatibility of a currency transaction tax with the EU Treaty freedoms. It was regarded as a barrier to intra-EU trade between Eurozone and non-Eurozone Member States. They also voiced against any tax that would reduce market liquidity and jeopardise the recapitalisation efforts of banks and the financial sector in general.

Different country experiences and the different level of development of financial markets across Member States were also pointed out as an argument against a common EU action.

b. Central governments/Ministries of Finance

One Ministry of Finance objected to any EU action contending that fiscal policy is within the ambit of Member States' competences and that the different impact of the crisis and situation of Member States' financial markets does not support an EU-wide approach. It also strongly opposed the extension of other Member States' taxing powers beyond their fiscal borders and

taxing separately capitalised legal entities in other Member States (spill-over effect). Another Member State also presented a similar argument that financial markets of Member States were affected differently by the crisis and the fiscal support took different forms. Both Member States claim that the financial sector in their jurisdictions is not under-taxed.

The two other Member States would accept financial sector taxation, including FTT, but at global level. While noting the technical difficulties related to a FTT, one of those Member States would also accept an EU-wide FTT. Nevertheless, that Member State would prefer a FTT in the form of a currency transaction tax due to lower relocation risk and easier technical implementation. It also has reservations with regard to FAT and especially rent/risk taxing FAT.

c. Local authorities

Local authorities (mostly representatives in the Committee of Regions) accept a broad based FTT at EU level. The argumentation and the actual replies repeat the arguments voiced by NGOs and trade unions.

d. Citizens

Citizens' individual submissions and the very large number of petitions are generally in favour of a broad-based FTT.

4. FOCUSED CONSULTATION WORKSHOP

On 4 May 2011 a focused consultation workshop with representatives of relevant associations of financial market operators[7] took place at DG TAXUD's premises.

The agenda of the workshops included a preliminary summary by TAXUD of the results of the public consultation, a round-table on industry's assessment of expected administrative costs related to FTT and FAT and a number of technical issues, including those covered by the public consultation questionnaire.

4.1. Taxud's preliminary summary of the results from the public consultation

TAXUD gave a presentation on the Impact Assessment on financial sector taxation and progress made so far (current debate, assessment criteria, FTT, FAT and balance sheet taxes, preliminary results for the public consultation, technical questions).

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[7] European Association of Cooperative Banks, European Savings Bank Group, European Banking Federation, European Association of Public Banks, Association of International Life Offices, Comité Européen des Assurances, Association of European Cooperative and Mutual Insurers, Association Internationale des Sociétés d'Assurance Mutuelle, European Fund and Asset Management Association, Alternative Investment Management Association, The European Forum of Securities Association, European Central Securities Depositories Association, International Capital Market Association, Federation of European Securities Exchanges,

- **EFSA (securities)** said a clear justification for under-taxation should be provided by the Commission and whether the introduction of new taxes at EU level is justified. They stressed that some Member States already took measures to compensate for the cost of crisis.

  TAXUD noted that 10 Member States already introduced bank levies.

  EFSA also pointed out that their members would not be in favour of a bank levy at the EU level (Member States already have country-specific levies in place, additional tax may cause distortion effects).

- **EFAMA (funds)** asked what was the rationale to use new corrective measures and that a cumulative effect (taxation at EU level vs. Member State level) should be considered. It should also be defined what will the tax revenues be used for and whether they will go to the EU budget. They also pointed out that it may be hard to get agreement on taxation at EU level as unanimity is required for both adoption and amendment, therefore the tax instruments are not as flexible and practical as regulation.

- **EBF (banks)** said that a clear justification for the under-taxation should be provided. They wondered whether the Impact Assessment would be sufficiently holistic and whether all policies (Lisbon strategy, FSAP, capital adequacy rules, accounting issues, etc.) are taken into account, i.e. cumulative effect on the financial sector. They stressed that the burden on financial sector is already very high. They also mentioned "Giovanni Group" which produced two reports where they listed the barriers in the internal market and taxes on financial transactions was one of them.

- **EACB (banks)** pointed out that the Commission should analyse the proportionality of measures (costs/benefits of the implementation). TAXUD explained that proportionality is at the core of any Impact Assessment. TAXUD said that the assessments of costs would be welcome from meeting participants.

- **EAPB (banks)** also pointed out that FTT could be a new barrier in the internal market. They also said that the Commission should use precise wording (e.g. "fair and substantial"), it is also unclear what is behind "additional burden" and pointed out that in some Member States constitutional problems may arise related to introduction of new taxes.

4.2. Industry's assessment of expected administrative costs related to FTT, FAT and balance sheet taxes (bank levies)

TAXUD explained in the introduction that some associations were already part of EU Savings Directive exercise in assessing expected administrative costs, so they already know it is very difficult to quantify costs. However, it is a strict obligation for any Impact Assessment to provide this quantification. TAXUD said that some cost estimates of Member States when introducing new taxes are available and pointed out that the Commission does not have sufficient time at disposal for an in-depth cost analysis.

- **EFAMA (funds)** said that there are opposing views which of potential new taxes, FTT or FAT, would be more costly. There are no clear estimates as the design of the new tax is

not known, however, the interest of market participants is to proceed in a least painful and cheapest way possible.

- **EBF (banks)** pointed out that in "Giovanni report" (financial transaction type taxes is mentioned as a barrier) there is a reference to the administrative costs of central clearing and said that a narrow-base tax would be costly, even more for a broad-base tax as it would be hard to identify who is the collector of the tax. They also said that for FAT the cash-flow based approach is incompatible with the financial statements approach (accrual base) and pointed out that a specific system would be needed. They concluded that it is impossible for the EBF to provide a cost estimate as there are too many options proposed with no defined design.

4.3. Technical issues

4.3.1. Industry scope

TAXUD explained that FAT would need a definition of the industry scope. Bank levies, for example, apply to banks only (HU- implementation is broader as regards the industry scope, whereas in the UK there are explicit carve-out clauses for some activities). Financial sector taxation would need to cover a broader industry, not only banks (IMF also advocate for a broader industry scope). Commission's definition is also broad.

- **BIPAR (insurance)** said that the insurance sector is perceived as being undertaxed as it is VAT exempt like banks, however, there are other taxes like the insurance premium tax. They mentioned the VAT directive Council revision which is ongoing.
- **EUSIPA (derivatives)** stressed that it should not be said that the financial sector is under-taxed due to VAT exemption as that is an indirect taxation and pointed out that the final consumer is under-taxed. They also said that FAT (addition method) is a sort of VAT (interaction with Art. 401 of VAT Directive), there is also an employment tax for banks or "la taxe boursière" for the operations on the stock exchanges. They also questioned whether the existing VAT system is in favour of banks.
- **EBF (banks)** pointed out that the VAT system is very complex, in 2007 there was a proposal for VAT treatment of financial services, so they proposed that the solution should be found within VAT as adding new taxes may further increase the complexity. EBF also said that the creation of disparities in the financial sector should be avoided and that FTT and FAT may not be able to identify what is excessive risk taking, at the end one cannot prevent the banks from taking risks
- **EFSA (securities)** said that if the justification for new taxes is under-taxation of certain activities (level playing field for all market participants) one should look at "shadow banking".

  TAXUD explained that risk has not been properly assessed and has been isolated in special purpose vehicles. It may prove to be challenging to tax those entities. EFSA said that risk is inherent and if there is a problem the taxpayer should not be required to sort it out. Banks take credit risks on a daily basis, it is their business, management measures are important in reducing risks.

- **CEA (insurance)** said that not all market participants can be treated in the same way as different actors have different risk, so there is a danger that one sector will end up paying for other sectors (cross subsidisation).

- **EAPB (banks)** provided an example of Germany which introduced bank levy, however the so called "promotional banks" (state-owned banks with state guarantees) were exempt from bank levy as they work in the public interest.

- **EACB (banks)** pointed out that limiting the scope only to financial sector is too narrow; also other entities should be included.

- **EFAMA (funds)** pointed out that there is limited scope for "excessive" risk taking as regulatory measures were already put in place in order to reduce the risk.

4.3.2. Availability of relevant accounting data

TAXUD explained that financial statements may differ across industry (even for the bank levy). IFRS consolidated financial statements are widely used (with the exception from US GAAP).

- **EFSA (securities)** stressed it is important to know which type of accounts would be taxed, individual or consolidated: taxing rights are broad, so there may be an issue of double taxation.

  They also explained that in the UK the basic idea for bank levy is to use consolidated accounts. For those who do not have consolidated accounts, they would need to put together a new balance sheet which may entail additional administrative costs.

- **EBF (banks)** asked how would those who have no consolidated accounts be taxed. They also said that in some Member States it is prohibited to use the IFRS at an individual level.

  EBF committed to check with banks and provide estimates how many banks would face problems due to the fact that they do not have consolidated statements.

- **EACB (banks)** said it was a question of scope as it may happen that those who do not provide consolidated accounts will not be taxed. They said that cooperative banks only provide annual accounts at national level, only listed banks have consolidated accounts.

4.3.3. Under/over taxation

CEA (insurance) pointed out that insurance premium tax is a national based tax, but present all over Europe (15%-20% on average), it is burdensome for the sector (Germany more than EUR 10 billion/year).

- **EBF (banks)** stressed a more holistic approach is needed as banks have to comply with many regulative requirements already.

- **EFAMA (funds)** wanted to know what is the rationale for the initiative, is it meant to be short or long-term measure. It may take many years to see what is the effect of new regulatory measures.

  They also wanted to know if the Commission knows how much tax revenues would be raised with new taxes introduction.

  TAXUD explained that the main purpose of the Impact Assessment is the overview of all possible new measures.

- **EUSIPA (derivatives)** pointed out it should be made clear how this new revenue would be spent.

4.3.4. Interaction with VAT and CIT/PIT

TAXUD explained that FAT additional method is essentially linked to VAT.

- **EUSIPA (derivatives)** explained the "Poddar system" (1999) which has not been accepted as Member States were not certain of the results for tax revenues of such taxation.

  They explained that "Poddar system" is in fact income tax on a rough basis which was stopped as Member States were against as it was considered impractical.

  TAXUD explained that that FAT additional method is not necessarily linked to VAT through VAT credits, (i.e. clients would not receive a "FAT invoice") and therefore the uncertainty about the tax revenues may be minimised.

- **EFSA (securities)** inquired what would be the justification for expanding the scope of VAT (i.e. FAT additional method) and questioned the consequences.

- **EBF (banks)** stressed that some Member States are using "option to tax", it is also a way how to apply VAT to all or some financial services by Member States. Proposal for a new directive for VAT reform services in 2007 (option to tax for the financial institution, not for Member States). If the debate evolves this may lead to economic double taxation as tax basis will be the same.

4.3.5. Double taxation

TAXUD explained problems with double taxation in case of FTT, FAT and bank levies.

- **EUSIPA (derivatives)** said there are already indirect taxes in the financial sector, so if FTT or FAT are added there will be a double taxation and pointed out that such taxation should integrated into the VAT systems. They referred to the ECJ case law ("Chicago case").

  TAXUD asked about source based vs. residence based VAT. EUSIPA could not comment.

They said that with regard to tax base for derivatives (futures, swaps), only the "result" (difference between open and end price) should be the tax base, more like an income tax as the futures can be perceived as betting. They consider that imposing tax on notional value of derivatives would harm the derivatives market and questioned how structured products would be taxed.

- **EBF (banks)** said that there is a contradiction when it comes to taxing derivatives. The objective is to reduce excessive risk taking by taxing notional value of derivatives; however a swap is a tool for risk reduction.

4.3.6. Relocation and competitiveness

EUSIPA (derivatives) said that when the resident of the state participates in a transaction, the place of taxation should refer to residence. Tax should be levied by bank, intermediaries, i.e. paying agents who collect taxes. On the other hand, one cannot control or forbid OTC transactions.

- **EFSA (securities)** expressed concern about new EU taxes as they would reduce the competitiveness of the EU. Relocation is easy and EU could lose its competitive position against non-EU based financial institutions (e.g. relocation to Switzerland, Singapore).

  EFSA said that in case of foreign exchange trading there is a revenue estimate that 75% of FTT revenue would come from London. They wanted to know what would be the margins in case of FTT and wondered whether a rate of 0.01% might "kill" the market.

- **EBF (banks)** said that in case of broad base FTT there should be a link to central depositary system.

  TAXUD explained there is a resident principle of the trading party (the person is taxed on global basis), source principle (every transaction within the state is taxed) and "UK stamp duty" principle where the transfer of securities which are registered in the country is taxed (legal certainty).

- **EACB (banks)** wanted to know if there is a differentiation between real currency transactions vs. speculative transactions and pointed out that in case of currencies it will be hard to administer the tax.

  TAXUD explained no differentiation can be done, all currency transactions would have to be taxed.

4.3.7. Credit supply (cost of credit)

EUSIPA (derivatives) said that whenever a new system is introduced, there will be administrative costs. They mentioned the example of Germany when introducing the withholding tax where the costs were very high.

EACB said that they can provide some figures on administrative costs of WHT implementation in Germany. They will send the information to TAXUD within a week.

They also said that one can use a bank deposit to circumvent FTT as there is a small difference between such a deposit and bonds.

- **EBF (banks)** said that any new tax burden born by financial institutions will be transferred to shareholders and customers and it does not depend on a tax base.

- **EFAMA (funds)** pointed out the impact on cost of saving and pensions.

4.3.8. Interaction with regulation (cumulative impact)

EBF (banks) said that there would be double taxation resulting from existing national taxes at Member States level and potential new taxes at EU level.

- **EUSIPA (derivatives)** suggested to change the EU Directive on capital duty as there are Member States that are not in favour of such taxation, but this may prove difficult in practice (unanimity).

5. CONSULTATIONS WITH ACADEMIA AND PRACTITIONERS

The Brussels Tax Forum[8] on "Taxation of the Financial Sector" was held on 28 and 29 March 2011. The audience and the presenters included a large number of academics, tax practitioners, policy-makers and other stakeholders.

The main topics discussed were as follows:

- responsibility of the financial sector for the crisis;
- the public support for the financial sector;
- under/over taxation of the financial sector;
- interaction with initiatives in the area of financial regulation;
- options for taxing the financial sector – FTT and FAT.

Tax Forum, Day 1

Opening Speeches

The opening session set the political scene for the debate on financial sector taxation (FST). The priorities in the Commission agenda and the recent initiatives, illustrated by Commissioner Semeta in his opening speech, were generally received with favour by the European Parliament, as Ms S. Bowles (Chaiwoman EP's Committee on Economic and

[8] http://ec.europa.eu/taxation_customs/taxation/gen_info/tax_conferences/tax_forum/index_en.htm

Monetary Affairs) pointed out in her intervention. With specific regard to FST, she mentioned the EP report on Innovative Financing which proposes an FTT potentially able to generate € 200 billion per year in the EU. Such tax would have a low rate (0.01% - 0.05%) to minimize relocation risk and a broad base. The need for action in the field of FST was also stressed by Mr. A. Balog (Hungarian Deputy State Secretary for Taxation Affairs) in the framework of a more general reconsideration of the design of the tax systems after the crisis. Finally, Mr. Ph. Etienne (French Presidency of the G20) highlighted the need for a coordinated approach on FST initiatives. In particular, while an FTT at the global level would be preferable, adoption only within the EU can also be considered if no consensus would be reached in the G20.

Session: Why taxing the financial sector?

Mr. P. Delacroix (PwC and Solvay Business School) illustrated the preliminary findings of a study commissioned by DG TAXUD on the national fiscal rules applicable to the financial sector in the EU27 and 4 major economies (Switzerland, USA, China and Singapore).

The legal treatment of banks in the CIT field does not significantly differ from that of non-financial corporations. In addition, there is no indication of actual practices differing from legal provisions and allowing of special tax treatment for banks. A few rules derogating from the general CIT principles concern provisions on loans/doubtful debtors, thin cap rules, interest deduction for banking branches, withholding tax exemptions, the accounting treatment of financial instruments (mark-to-market/mark-to-model).

In the domain of indirect taxation, the well known difficulties in measuring the value added for margin-based activities have led to a generalized exemption of financial services from VAT. The 'option to tax' (art. 137(1) (a) of Directive 2006/112/EC) is implemented in 7 MS. Nearly all MS have introduced other taxes on financial services, not all specifically compensating for the VAT exemption. For instance, in France and Denmark there is a compensating payroll tax on salaries apportioned on the basis of pro rata taking into account turnover that is VAT-exempt. Similarly, 19 MS have an insurance premium tax or similar tax. Other taxes such as stamp duties, stock exchange taxes, bank levies, special contribution taxes, government levies, registration taxes, mortgage taxes are also levied. There is no differentiated fiscal treatment of labour income in 24 countries. Amongst the 7 countries that have reported a different tax treatment, France and UK have already abandoned their measures. Moreover, while Greece, Italy and Portugal have applied tax surcharges on bonuses, Ireland will tax future bonuses – as a response to the crisis.

Finally, forms of securities transaction taxes already exist in 8 EU MS (France, UK, Belgium, Poland, Greece, Romania, Ireland, Finland), with different characteristics: various tax rates (generally from 0.15% to 1.6%); with or without ceiling/maximum amount of tax due; with a broad tax base (all financial instruments, including derivatives) or not (e.g. only equities, or only listed stocks, or only local securities); with potential exemptions, e.g. for non-resident taxpayers, or institutional investors acting for their own account.

In the second intervention of this session, Prof. H. Huizinga (Tilburg University) addressed the issue of potential under-taxation of the financial sector. When it comes to the CIT, there is no evidence that shareholder returns enjoy lower tax levels than other sectors. Of course, this might also be indicative of the benefits of any potential under-taxation being passed on to bank customers and suppliers.

Implications of VAT exemption cause financial services to households to be under-taxed, while services to businesses to be overtaxed. Overall, exemption can lead to overtaxed or under-taxed financial services, depending upon the share of business demand in financial services and the magnitude of irrecoverable VAT. Drawing on his own research, the author quantified the potential increase in overall VAT revenue from eliminating the existing exemption around € 12.2 billion euros for EU15 in 1998. This could be translated into € 18 billion for EU27, or 0.15 % of EU27 GDP.

In stressing the need for considering tax incentives in addition to the mere level of taxation, prof. Huizinga also clarified that schemes like deposit insurance, liquidity provision by the ECB and bailout of ailing financial institutions can be considered as implicit fiscal instruments. In particular, the transfer from the liquidity provision from the ECB (assuming a 5% spread with the rate obtainable on the market) amounts to roughly 1.0 percent of euro zone GDP, over entire crisis. If crisis occurs every 30 years, the yearly cost amounts to 0.03 % of GDP. In addition to that, the direct fiscal cost of the 2007-2009 crisis amount to 1.7 % of EU27 GDP (0.06 % a year under the assumption above). Leaving aside the (substantial) output losses generated by the crisis, adding up the figures above would give a total under-taxation of the financial sector in the range of 0.24% of EU27 GDP per year. In the IMF calculations, additional revenues of this magnitude can be generated by a broad Financial Activities Tax with rate of 5 %. Importantly, less additional revenue is needed if new regulation and taxation can reduce bank risk taking.

Among the points raised in the panel discussion, particularly relevant are the observations made on the ability of financial institutions to avoid current tax provisions, e.g. through tax planning. In particular, gathering evidence on effective tax rates for banks seems of primary importance.

Tax Forum, Day 2

Morning session: The financial transaction tax

The morning session of day 2 of the Brussels Tax Forum dealt with the Financial Transactions Tax and was chaired by Karel Lannoo (CEO of Centre for European Policy Studies), who set the scene by making references to existing taxes of this type – namely in the UK and Switzerland.

The first part of the session included a presentation by Prof. Stephan Schulmeister (Austrian Institute of Economic Research). He outlined briefly the planned tax base, which would be the value of any traded financial asset, while the possible tax rates are 0.1%, 0.05% and 0.01%. Necessarily higher leveraged financial assets would be affected to a great extent. The policy reasoning behind this is minimisation of short-term speculation (60-70% of trade is through high-frequency trading) and stabilisation of the markets, which would, according to Prof. Schulmeister, also have a long-term effect on preventing the formation of pronounced bull/bear markets, because the long-term bull/bear market is an extension of the short-term trends. He claimed that the same mechanisms were into play with regard to the CDS and sovereign debt crisis.

In Prof. Schulmeister's revenue calculations of 1.8% of EU GDP a scenario of 70% reduction in derivatives trading is taken into consideration. The collection would be done at the point of settlement, while all OTC transactions would be taxed at the level of the Central Counterparty Platforms (CCPs). All countries in the same or similar time zone would need to participate. Revenues would be shared among the trading place, the trading partners' states and the EU. If a decentralised approach is adopted, a charge of 2% would need to be applied on all transfers of funds abroad.

Prof. Schulmeister went on to address criticism on his ideas arguing that price discovery has turned into price distortion. He argues that other versions of financial sector taxes such as the FAT and bank levies treat equally the "harmful" and traditional "boring" banking. In addition, the FAT or bank levies cannot address the speculative practices by other businesses.

The second presentation was done by Prof. Seán Yoder (University of Maine). He gave a brief overview of transaction taxes in general and their practical implementation, especially in Latin America. They are seen as a way of taxation of an activity (and not of income or expenditure) and to correct negative externalities. He criticised the cascading effect of those taxes and their negative effect on liquidity (whose effects would be felt far beyond the financial sector) and also hinted towards the possibilities of circumvention by was of netting settlement agreements.

Prof. Yoder went on to question the revenue shortfalls and significant relocation risks, and because of the globalisation of the financial markets cannot fulfil it Pigouvian role. As a substantial and stable revenue raiser, he dismissed the financial transactions tax as underperforming. For a currency transaction tax, Prof. Yoder gave an example of cross-trading that is done between less-common currencies. If Euro transactions were subject to an FTT, cross trading would shift to USD positions.

The presentations were then followed by a panel discussion, which included Roger Kaiser, Senior Adviser, Tax & Financial Reporting at the European Banking Federation, Max Lawson, Head of Development Finance and Public Services at OXFAM, Jeffrey Owens, Director of the Centre for Tax Policy and Administration at OECD, Victoria Perry, Division Chief of the Revenue Administration Division at the Fiscal Affairs Department at the IMF, Stephan Schulmeister, Economist at the Austrian Institute of Economic Research and Seán Yoder, Professor at University of Maine.

Jeffrey Owens presented some of the arguments for levying a tax on the financial sector, e.g. the need of fiscal consolidation, the need to pay for the financial crisis, to "put sand in the wheels" of the spurring markets, to discourage risk-taking and compensate for the opportunities for aggressive tax planning exploited by the financial sector actors. New regulation and tax must send coherent signals (but not to undermine banks' recapitalisation) and there is need for coordination in that respect.

Victoria Perry also made a short description of the difference between the FAT and the FTT. FTT was seen as more distortionary due to its cascading nature and could increase volatility. On the FAT, she argued that economic rents may exist in the financial sector from the "too big to fail" assumption, but also from the perceived "complexity" of products and schemes. Excessive leverage and not excessive trading was seen to describe more appropriately the genesis of the financial crisis. That view was also shared by Jeffrey Owens.

Roger Keiser argues that the imposition of taxes conflicts with the banks' recapitalisation. Any tax burden would be more easily passed onto clients thereby increasing the cost of credit. A narrow-based FTT would be easily administered, but would pose problems of relocation to less institutionalised and less secure markets. A broad-based FTT would on the other side have problems with enforcing, collection and compliance. On FAT, he argues that it must be compatible with existing accounting information and not require a specific set of accounts. A cash-based FAT was seen as less proportionate compared to a standard VAT on the financial sector. Duplication of EU and national bank levies would need to be avoided.

Max Lawson pleased for a "Robin Hood tax" to aid developing countries, which was threatened by the fiscal consolidation efforts of developed countries. He raised support for any tax on the financial sector, with preference towards an FTT.

The ensuing debate focused on whether economic rents were generated by excessive risk taking of economic efficiencies, the effect of FTT on market volatility (and the definition thereof), the causal link between financial instruments' leverage and the volumes traded, the challenges of distinguishing "gambling" from sound financial activities and the effectiveness of taxation as compared to regulation.

Afternoon session: The Financial Activities Tax

The closing session of the Brussels Tax Forum dealt with the Financial Activities Tax and was shared by Professor Marcel Gérard (University of Louvain-La-Neuve). Professor Clemens Fuest (Oxford University) set the scene by explaining the basic concept of a FAT and highlighted that there is in fact no single FAT proposal but that it is rather a family of taxes which differ significantly in their design. Professor Fuest elaborated on the three types where the addition-method FAT is essentially an instrument to correct at least partly the VAT exemption of many financial services. For this reason the tax is based on the sum of wages and profits which is a rough proxy for value added-of the financial sector. The rent-taxing FAT is more directed to potential economic rents while the risk-taxing FAT is more directed towards a regulatory goal, namely the reduction of risk-taking in the financial sector. He pointed to potential administrative problems and high compliance especially with regard to the latter two versions of FAT.

Professor Fuest concluded that before thinking about a FAT as an additional tax instrument it would be helpful to first fix issues in current tax systems. Specifically, he pointed to first getting the newly introduced bank levies right, notably the issues of double taxation, fixing the issue of VAT exemption for financial services within the current VAT if possible, reforming general corporate income taxation (debt bias and other issues), reforming financial sector of regulation, in particular capital requirements and after that to start reconsider FAT.

Professor Peter Birch Sorensen (Danmarks Nationalbank) presented the Danish experience with a variant of the FAT which is designed to correct at least partly the VAT exemption of the financial sector. The Danish tax is levied on the payroll of sectors which are VAT exempt. With respect to the financial sector, the tax applies to banking, insurance, mortgage credit and pension funds with a rate of currently 10.5%. Professor Sorensen elaborated on the concept and also gave some indications on whom the burden of such a tax might fall. When comparing wages and employment in the financial sector as well as interest spreads in

Denmark, the Danish tax did not seem to have negative effects on those. Rather the indicative data suggests that the burden was borne to a large extent by capital owners of banks.

Professor Sorensen pointed to the fact that the Danish tax misses an important element compared to the FAT currently debated internationally. It does not include profits in the tax base. He suggests that his could be considered since this would make the tax a better tool to tax value. Professor Sorensen concluded from the Danish experience shows that an origin-based FAT can be implemented as (an imperfect) substitute for the missing VAT on financial services and that with a moderate tax rate, there is no reason to fear that a FAT will seriously discourage financial sector activity. He also noted that an internationally coordinated FAT would increase the revenue potential and that there are no convincing technical arguments for excluding (pure) profits and stock options etc. from the FAT base.

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ANNEX 2

REGULATORY MEASURES IN THE FINANCIAL SECTOR

The following regulatory changes should be considered as constituting the baseline scenario from a regulatory perspective. The reforms address a number of problems identified above: reduce risk taking (proposals 1-10), risk surveillance (proposal 2), the definition and creation of proper capital ratios (proposals 1 to 7), misaligned incentives in remuneration schemes (proposal 1), a harmonisation of deposit guarantee schemes and the covering cost of future crisis (proposals 9 and 10), and dealing with Automated Trading (proposal 11). The relevant proposals are briefly summarized here:

(1) The definition of capital under CRD III and CRD IV

Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitizations, and the supervisory review of remuneration policies (so-called CRD III) impose an increase in capital required i) against banks' trading books, ii) for re-securitization positions of banks.

The Commission proposals, so-called CRD IV (Directive and Regulation)[1] to replace Directives 2006/48/EC and 2006/49/EC tighten criteria for eligibility of capital instruments for the different layers of regulatory capital and make extensive revisions to the application of regulatory adjustments.

(2) The revision to the counterparty credit risk under CRD III and CRD IV

The Commission proposals, so-called CRD IV (Directive and Regulation)[2] to replace Directives 2006/48/EC and 2006/49/EC strengthen the requirements for management and capitalization of the counterparty credit risk. The proposals also enhance incentives for clearing over-the-counter instruments through central counterparties. It put in place higher own funds requirements for bilateral derivative contracts in order to reflect the higher risk that such contracts pose to the financial system. It complements other Commission's regulatory initiatives in this area, in particular the proposed Regulation on OTC derivatives, central counterparties and trade repositories, adopted by the Commission on 15 September 2010.

(3) The treatment of the trading book under CRD III and CRD IV

Regarding the trading book under the so-called CRD III the following changes are of application:

[1] Likely to be adopted in July 2011
[2] Likely to be adopted in July 2011

- Adding an additional capital buffer based on stress scenario VaR to the ordinary VaR.

- Extending the existing charge for default risk in the trading book to capture losses short of issuer default, e.g. rating downgrades, to address in particular the fact that losses on traded debt most of the time did not involve issuers actually defaulting.

Basing the charge for securitization positions in the trading book on the (simple) risk weights that already exist for the banking book, addressing the methodological difficulties of modelling.

(4) The changes related to securitizations under CRD III and CRD IV

Under CRD III capital requirements for re-securitization positions of banks are increased (see point (1)). In line with the approach developed by the Basel Committee, for every credit rating grade, re-securitization positions would be assigned a higher risk weight than other securitization positions, with such higher risk weights being set in accordance with a higher risk of unexpected impairment losses. For particularly complex re-securitizations, CRD III reinforces both the due diligence requirements and the supervisory process to enforce them. The supervisors have to establish on a periodic basis whether due diligence standards for investments in certain types - as identified in advance by EBA - of highly complex re-securitizations have been adequately met. For these instruments, a general deduction from capital requirement would apply unless banks demonstrate that necessary due diligence standards have been met. In instances, where compliance with required due diligence is found to be inadequate, institutions would be debarred from investing in such instruments in the future.

Disclosure requirements are enhanced in several areas such as securitization exposures in the trading book and sponsorship of off-balance sheet vehicles.

(5) The liquidity ratio under CRD IV

CRD IV introduces two liquidity ratios:

- **Liquidity Coverage Ratio** (LCR). It would improve the short term resilience of the liquidity risk profile of financial institutions and require credit institutions to match net liquidity outflows during a 30 day period of acute stress with a buffer of 'high quality' liquid assets.
- **Net Stable Funding Ratio** (NSFR). It would address funding problems arising from asset-liability maturity mismatch and require credit institutions to maintain a sound funding structure over the one-year horizon in an extended firm-specific stress scenario where an institution encounters and investors and customers become aware, for instance, of a significant decline in its profitability or solvency, a potential downgrade in its debt, counterparty credit or deposit rating or a material effect that calls into question its reputation or credit quality.

(6) The capital conservation buffer under CRD IV

Proposals for capital buffers comprise a **capital conservation buffer** and a **countercyclical capital buffer**. The capital conservation buffer of 2.5% of risk-weighted assets is aimed at ensuring banks' capacity to absorb losses in stressed periods that may span a number of years.

Banks would be expected to build up such capital in good economic times. Those banks that fall below the buffer target will face constraints on discretionary distributions of earnings (i.e., dividend payments) until the target is reached.

The countercyclical capital buffer is intended to achieve the broader macro-prudential goal of protecting the banking sector and the real economy from the system-wide risks stemming from the boom-bust evolution in aggregate credit growth. It will be applied by adjusting the size of the buffer range established by the conservation buffer by up to additional 2.5%.

In order to limit an excessive build-up of leverage on credit institutions' and investment firms' balance sheets and thus help containing the cyclicality of lending, the Commission also proposes to introduce, as an element of the supervisory review, a non-risk based leverage ratio. Implications of the ratio will be monitored prior to possibly becoming a generally binding requirement on 1 January 2018.

(7) A calibration of the higher minimum capital ratios, under CRD IV

Under CRD IV, the new higher capital requirements are gradually implemented until 2019. Common equity Tier I has to be at least 4.5% (7% when the capital conservation buffer is added), Tier I capital has to be at least 6%, Total capital has to be at least 8% (same as before but its composition is shifted towards common equity and other better loss absorbing capital)

(8) A harmonised DGS

The draft Directive on Deposit Guarantee Schemes adopted by the Commission on July 2010 introduces a fixed coverage of EUR 100,000. The payout period is decreased to seven days. Ex-ante funding amounts to 2% of eligible deposits over a period of 10 years. Cross-border cooperation between DGS is increased.

(9) The resolution fund

In its Communication on bank resolution funds in May 2010, the Commission is proposing that national funds should be set up on the basis of contributions paid by banks (bank levy) to fund the cost of future resolution measures and ensure that resolving a bank is a credible option.

(10) High Frequency Trading (Algorithmic trading)

This issue will be addressed in the Revision of the Directive on the Markets of Financial Instruments. Notably, instead of levying a tax on all transactions a regulatory measure could be to impose an order to executed transaction ratio by imposing incremental penalties on cancelled orders and setting up minimum tick sizes. In this case market operators would need to ensure that their market participants maintain an adequate order to transaction executed ratio. It would impose that market operators impose a system of incremental penalties for cancelled orders. This would limit the number of orders that can be placed and then cancelled by high frequency traders. This would be beneficial for market efficiency and reduce stress on trading systems as it would prevent excessively large numbers of orders from being sent and then withdrawn and updated. It would also prevent behaviour where participants submit a multitude of orders withdrawing them almost immediately just to gauge the depth of the order book. In addition, the obligation for market operators to set up minimum tick size on their trading venues would prevent excessive arbitrage by HFT as well as unsound competition between trading venues that could lead to disorderly trading.

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Annex 3

REVIEW OF CURRENT PRACTICES FOR TAXATION OF FINANCIAL INSTRUMENTS, PROFITS AND REMUNERATION OF THE FINANCIAL SECTOR

This annex covers 4 different Chapters, namely:

- Corporate Taxation of the Financial Sector – Banks
- Value-Added Taxation of the Financial Sector
- Labour Taxation in the Financial Sector
- Taxation of Financial Instruments

The scope of this annex is to review current tax provisions directed at the Financial Sector in the 27 Member States as well as – for comparison purposes – certain key third countries: China, Singapore, Switzerland and the USA. The reference tax year is 2011.

CHAPTER 1: CORPORATE TAXATION OF THE FINANCIAL SECTOR

1. PURPOSE AND SCOPE OF THIS CHAPTER

1.1. Scope of the Study

1. Initially, it was contemplated that, for each of the below questions, and where applicable, the treatment for banks, insurance companies, credit card companies, stock brokerages, investment funds and government-sponsored companies should be detailed separately.

2. However, investment funds are generally subject to a special taxation regime, which differs according to their legal structure (that of a company or otherwise), the type of assets in which they invest (debt, equity, real estate, derivatives, commodities, and so on), and in relation to other features. Given the philosophy of the Study as mentioned above, we believe that, since the tax rules applying to investment funds are so specific (in view of their role as mere intermediaries), the result could be relatively confusing if investment funds were to be included in the scope of this Study. Indeed, given the diversity of the tax regimes applying to different types of investment funds, we have suggested a separate project to compare them and, therefore, investment funds have not been included within the scope of this Study.

3. In addition, because credit card companies, government-sponsored companies and stock brokerage companies are generally in a comparable situation to companies active in the non-Financial Sector, those entities have also been omitted from this Study.

4. Finally, in the interests of time and budget, insurance companies have also been omitted – with the Commission's consent. In a later stage, the Study could ideally be completed with a specific Chapter relating to insurance undertakings.

5. In conclusion, the questions raised in relation to corporate taxation relate only to 'banks', in the event that the tax rules applying to them differ from those applying to companies in the non-Financial Sector.

6. In their traditional acceptance, 'banks' are the most important category of credit institutions. Whereas their main activity still consists in receiving money deposits or other refundable funds from the public and in granting credits for their own account, the banking activity has in recent years been expanded and diversified and usually also includes the following activities: retail banking, business/corporate banking, investment banking or corporate finance, private banking and insurance banking. In the scope of this Study, we cover

all types of banks whatever their activities provided that they are regulated (i.e. they have a banking licence in their country of establishment).

1.2. General Purpose of the Study

7. Given the scope of the Study as detailed above, we understand that the Commission mainly wishes to conclude what differences exist in the corporate taxation of companies active in the Financial Sector (i.e. regulated banks in the framework of this Study) as opposed to those in the non-Financial Sector on the basis of input by the survey countries (listed above) to a questionnaire formulated by the Commission looking at some elements of corporate taxation.

8. As the intention is mainly to identify differences in corporate tax treatment between the Financial and non-Financial Sectors, in principle, the questions in the questionnaire need no reply if the tax rules applying to the Financial and non-Financial Sectors are the same. Please note that, to maximise the practical value of the Study, we took the liberty of asking each country involved to briefly comment on each of the questions, even if there is no difference in treatment. These comments do however not address the overall tax regime applying in the survey countries. This will allow the Commission to have a high-level overview of the applicable differences across countries, which is also an objective of the Commission with respect to this Study.

9. Based on the survey input, when comparing corporate taxation between banks and other companies within one country or when comparing the rules applying in different countries, the general tax regime applicable within the given countries should be borne in mind. For instance, because Estonia defers corporate taxation until the distribution of profits, concepts of 'tax deductibility' or 'taxable items' do not necessarily have the same meaning as in other countries providing for an annual corporate income tax based on accounting results.

10. The purpose of our comments is to provide a general overview of the main tendencies common to all the countries or, where relevant, relevant exceptions to our general observations.

11. They are not intended to detail all the items addressed in the responses to the questionnaire. For a thorough, detailed overview of the regime, rules or practice in a given country, we refer to the completed questionnaires attached to this Study (see Enclosure 9).

1.3. Questionnaire

12. This Chapter answers the following questions raised by the Commission:

A. General tax rules applying to banks

1. What is the applicable corporate income tax ('CIT') rate, including any surcharges and local taxes (in which case the capital city is considered)?
2. Do banks pay a special tax rate or can they qualify for a special tax rate?
3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If so, in what respect?
4. Do countries impose turnover taxes on gross interest and other income of banks?

B. Specific tax rules applying to banks

1. Do countries have specific tax-relief rules for certain specific items such as interest income?
2. Are there specific anti-avoidance rules (CFC, thin cap, etc.) that apply to the Financial Sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits?
3. Are (some) types of financial companies excluded from double-tax agreements?
4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?

C. Tax treatment of interest and dividends

1. How are paid interest and dividends treated for CIT purposes?
2. How are received interest and dividends treated for CIT purposes?
3. How are dividends on shares treated for tax purposes (from a WHT/WHT perspective)?
4. How is interest on advances and on securities of all kinds treated? Accrual basis, mark-to-market or included in the value of the security?
5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?

D. Tax treatment of certain specific gains/losses

1. How are gains and losses on fixed assets treated for tax purposes?

E. Tax treatment of certain financial practices/instruments

1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes?
2. How are assets held for trading purposes treated for tax purposes?

F. Tax treatment of bad or doubtful debts on advances and loans

1. How are bad or doubtful debts on advances and loans treated for tax purposes?

   (i) Is a minimum required for general provisions?
   (ii) Tax-deductibility of general provisions?
   (iii) Limitation on deductibility of general provisions?
   (iv) Are specific provisions discretionary?
   (v) Tax-deductibility of specific provisions?
   (vi) Limitation on deductibility of specific provisions?

G. Tax treatment of employee stock option plans

1. Are employee stock option plans deductible for CIT purposes?

H. Specific questions regarding banks

1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital?
2. For all the above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?

G. Practices

1. For all the above questions, is there any information as to whether actual practices may differ from the legal provisions?

As detailed above, the scope of this Chapter covers and is limited to the corporate taxation of banks in the 27 Member States of the European Union plus China, Singapore, Switzerland and the United States of America, so 31 countries in total. The reference tax year is 2011.

2. ACTION UNDERTAKEN

13. To gather the necessary information, we sent questionnaires with the above questions to our contact persons in the 27 Member States and the four third countries. Based upon the answers received, a detailed analysis was performed, including the necessary PwC quality checks. Where needed, PwC reverted back to the different countries for additional explanations.

Taking into account the input provided by the survey countries, we subsequently did a transversal reading of each question and the replies provided by each of the countries.

As a result, we identified certain common tendencies between certain countries or, by contrast, certain specific rules peculiar to one or a limited number of countries.

For the sake of completeness, we attach the different questionnaires as completed by the survey countries (see Enclosure 9).

3. RESULTS

3.1. General Tax Regime Applying to Banks

3.1.1. *Applicable CIT Rate, Surcharges and Local Taxes*

14. **Applicable CIT Rate.** As regards the applicable corporate income tax rate, most of the survey countries, if not all, do not provide a different standard corporate income tax rate for banks. The corporate income tax rate applying to banks is generally the same as that applying to other companies.

Notwithstanding the above, although not material, Austria provides for a minimum corporate income tax, which is due on an annual basis. In this respect the annual minimum corporate income tax due for banks amounts to EUR 5,452, whereas, in general, for non-financial institutions this annual corporate income tax is only EUR 1,750 (EUR 3,500 for public limited liability companies).

15. **Statutory Tax Rate.** For the purposes of the Study, the input provided by the survey countries – especially in relation to this first question – relates to the question whether banks benefit from a different nominal tax rate than the ordinary corporate tax rate applicable to other corporates. This Study analyses the 'statutory tax rate' or the 'standard tax rate', i.e. the rate that is applied on the taxable basis as determined by the applicable rules. The statutory tax rate or standard tax rate should not be confused with the "effective tax rate" (ETR) which is an accounting concept and which is not relevant with regard to this Study.

16. **Surcharges and Local Taxes.** Based on the input provided, we understand that local taxes may be applicable in a limited number of countries. We have received confirmation that local taxes are indeed applicable in Italy, Luxembourg, Portugal, Romania and the USA. The general conclusion is that the applicable local tax rate is the same for banks as for other companies. By way of exception, it appears that the reduced local tax rate available within the Madeira Region (Portugal) is not applicable to banks. For the purposes of this Study, we consider local taxes as meaning additional taxes, i.e. on top of corporate income tax, levied by or in favour of local authorities, on income generated by banks. Essentially, these local taxes are thus levied on the same type of income as corporate income tax. Except as otherwise indicated, we do not include in the Study any references to other specific taxes levied by local authorities such as real estate tax, computer tax, office's tax, ATM's tax etc.

3.1.2. *Special Tax Rate for Banks*

17. **No Special Corporate Income Tax Rate.** None of the survey countries reported a special corporate income tax rate for banks.

3.1.3. *Computation of the Tax Base*

18. **Computation of the Tax Base.** For computing the corporate tax base, all countries state that, in principle, it is based on the accounting result as determined by the financial statements drawn up in accordance with the applicable accounting standard (IFRS, local GAAP, etc.).

In this respect, it should be noted that, taking into account the specific nature of financial activities and financial products, there may be specificities in the accounting rules applying to financial institutions or banks, which may influence the accounting result and thus the corporate tax base. In addition to the accounting specificities that may apply to the banking sector, tax laws of certain countries also provide for certain tax adjustments that might not always be specific to banks but that, due to the nature of banking activities, could nonetheless have a more relevant impact on their tax base as opposed to that of other companies. For the sake of clarity, the present Study does not cover the accounting treatment applicable to banks, nor the impact of said accounting treatment on the computation of the tax base.

19. **Tax Adjustments.** The tax adjustments mentioned above relate, for instance, to provisions for bad or doubtful debtors, taxation of unrealised or realised gains and losses on certain financial instruments, application of the participation exemption regime for dividends and/or the capital gains exemption in the case of trading assets and certain thin capitalisation rules. These tax adjustments are further detailed below.

20. **Tax Losses.** In relation to determination of the tax base, we have also been told by Hungary that, specifically for banks, tax losses incurred in and before 2008 cannot be carried forward.

3.1.4. *Turnover taxes*

21. **Turnover Taxes.** Apart from France and China, no other countries reported any turnover taxes on gross interest or other income.

In France, a 'value added contribution' ('Cotisation sur la valeur ajoutée des entreprises') is assessed on the added value of French companies. This applies to banks and other companies where their turnover exceeds EUR 152,500. The tax is computed by applying a progressive rate ranging between 0% and 1.5% on the added value of the company. Both turnover and the added value are calculated according to special provisions for banks (e.g. 95% of dividends

deriving from long-term investments are not taken into account instead of a complete exemption).

In China, a 5% business tax applies to gross interest and other income of banks.

22. **VAT.** For those countries explicitly referring to value-added tax, it was mentioned that banking services and activities are generally exempt from VAT and, as a consequence, banks may generally not deduct the VAT suffered on their incoming invoices. We refer to Chapter 2 of the present Study for more details with respect to some VAT aspects applicable in the Financial Sector.

3.1.5. *Conclusion*

23. **Conclusion.** Based on the above, at first sight and based on the common parameters as detailed above (tax rate, tax base, turnover taxes, etc.), it can be concluded that there is generally a limited difference in tax treatment between banks and other companies, with the exception of bank levies described below.

We refer to Enclosure 1 for an overview table of the corporate income tax rates, local taxes and special levies per survey country as summarised by the various jurisdictions.

3.2. Specific Tax Regime Applicable to Banks

3.2.1. *Tax Relief Rules*

24. **No Specific Tax Relief Rules.** Apart from Singapore, no country identified any specific tax relief applicable to certain specific types of income received by banks as opposed to other companies. In all the survey countries (except Singapore), interest income is subject to the standard CIT rate and there is no particular income tax deduction/relief for interest income in the case of banks.

In Singapore, banks can apply a reduced concessionary tax rate for income from high-growth and high-value-added activities such as relating to the bond market, derivatives market, etc. (so-called standard-tier) or for income from a broader range of financial activities that are important to the development objectives of the Financial Sector in Singapore (so-called enhanced tier) such as lending in foreign currencies, treasury activities, etc. The reduced concessionary rates for both types of income amounts to 5% and 12% (instead of 17%), respectively. These tax incentives are included in the so-called 'Financial Sector Incentive' Scheme, which is designed to promote and encourage further development of Singapore as a prominent financial services hub.

3.2.2. *Specific Anti-Avoidance Rules*

25. **General Comments.** In order to reduce the tax that due, a company may utilise the applicable tax regime to its own advantage. For instance, in relation to their funding requirements, companies can choose to be funded via equity or debt. Generally, debt financing brings additional tax benefits compared to equity financing considering the fact that interest expenses are generally tax-deductible (whereas dividends are distributed after tax and thus are not deductible). By means of high debt financing, the tax base may be eroded through interest expenses. With the aim of discouraging excessive or abusive use of financing methods that impact the tax base, the majority of countries have introduced anti-avoidance rules, which may be general or specific (i.e. aimed at specific expenses, transactions, etc.).

26. **Thin Capitalization Rules.** In order to limit risk in the case of excessive debt financing (solvency risk for creditors) and so minimise the adverse tax consequences of excessive interest deductions, certain countries have set up 'thin capitalisation rules' or rules 'limiting interest deductions'.

In general terms, thin capitalisation rules determine how much of the interest paid on corporate debt is deductible for tax purposes, thus limiting the amount of interest deduction when a certain debt-equity ratio is exceeded. In certain countries, rules also provide for a limitation of interest expenses, for instance when they exceed interest income (this is the case in the Netherlands, for instance).

Thin capitalization rules are applicable in the majority of the countries in scope of the Study, with the exception of ten countries (Belgium, Cyprus, Estonia, Finland, Ireland, Italy, Malta, Slovakia, Sweden and Singapore).

27. **Various Categories of Thin Capitalization Rules.** The countries in which the thin capitalization rules apply may be divided into three categories:

1. The countries in which the thin capitalization rules apply in the same way to the banking sector as to the other sectors (Austria, Germany, Lithuania, Luxembourg, the Netherlands, Poland, Portugal and the USA);
2. The countries in which the thin capitalization rules apply to banks, but in a different way (Czech Republic, Hungary, Switzerland, the UK and China); and
3. The countries in which banks are excluded from the thin capitalization rules (Bulgaria, Denmark, France, Greece, Latvia, Romania, Slovenia, Spain).

In Germany, although the thin capitalization rules are similar for banks and companies in other sectors, in practice, the banks will however not be burdened by the German thin capitalization

rules (due to the fact that interest expenses are always deductible to the extent they do not exceed interest income earned).

Where the thin capitalization rules differ for the banking sector, the difference may be in the applicable debt to equity ratio. For instance, in the Czech Republic and China, the debt to equity ratio applicable to banks is higher. The difference may also be present in the borrowings which have to be taken into account to compute the debt to equity ratio. In Hungary for instance, banks do not have to take into consideration their liabilities in connection with their financial services activities, and in the UK group's external borrowing are not taken into account to determine the debt cap restriction. These differences are due to the nature of the activities of a bank. Indeed, in order to enable a bank to perform its lending activity, the bank itself needs to fund this activity through borrowings.

We refer to Enclosure 2 for an overview table of the applicable thin capitalization rules, as well as the differences applicable to banks, where relevant.

28. **Incentive Rules for Equity Funding.** For the sake of completeness, it is worthwhile to mention that in contrast to the above 'negative' rules to prevent an entity being 'thin capitalised', certain countries may also provide for positive incentive rules from a tax perspective to encourage companies to be equity funded. For instance, Belgium has introduced a notional interest deduction regime, which mainly consists in a tax deduction corresponding to a notional interest cost computed on adjusted equity capital. This regime was introduced to (re)equilibrate the tax treatment of equity funded companies and debt funded companies.

29. **Other Anti-Avoidance Rules.** It should be noted that not all countries have anti-avoidance rules. Where domestic legislation does set down anti-avoidance rules, they generally apply to all companies, and thus not specifically or solely to banks. In this respect, only the USA has reported certain specific anti-avoidance rules applying to the Financial Sector, and thus to banks (many relate to profit offshoring). It should also be noted that the case law of the Court of Justice of the European Union has set stringent rules to the application of these rules in the light of the European freedoms.

30. **Conclusion.** Very few countries have enacted specific tax rules to limit interest deductions by banks.

This can probably be explained by the fact that accepting deposits from customers (and granting loans), coupled with the payment of interest on those deposits, is the core activity of the banking sector. Hence, there is little tax incentive linked to the deduction of interest payments; they are more a business characteristic inherent to the Financial Sector, especially banks.

In addition, at least one country also explicitly referred to applicable capital requirements from a regulatory perspective, under which banks' funding should be sufficiently regulated in principle and hence no further corrective measures (from a tax perspective) need be undertaken in this respect. Generally, such regulatory provisions (such as Basel I, Basel II, the EU Capital Requirements Directive reflecting Basel II, etc.) are intended to create an international standard that banking regulators can use to determine the capital/resources banks need to have to protect them against the financial and operational risks they face.

3.2.3. *Double Taxation Treaties*

31. **Treaty Access for Banks.** Where there are double taxation treaties between the survey countries, none of them has reported that, provided they can be considered to be corporate bodies, banks are excluded from the benefits they procure.

In other words, banks, just like any other standard company, can in theory benefit from the advantages of double taxation treaties if they qualify as a 'resident', as defined by the treaties: this will be so in most cases (subject of course to a case-by-case analysis under the laws of the relevant country, the specific situation of the taxpayers involved and the double taxation treaty in question).

3.2.4. *Branch v. Subsidiary*

32. **No Specific Taxation Rules.** There are no specific taxation rules that treat banks organised as branches differently from those organised as subsidiaries.

33. **Interest Deductibility.** Certain countries nonetheless specify that branches of banks – as opposed to other branches –, may deduct interest paid on loans received from their head office due to the specific nature of their finance activities (for instance Belgium, Portugal, Spain and the UK).

Generally, in the case of a head office and branch structure, the head office will allocate a capital to its branch to enable it to secure its activities. In principle, because a branch cannot be considered a separate legal entity, any interest due on this working capital is, if it is structured as a 'loan', not deductible in the branch's hands (because it is paid to itself, legally speaking). However, this is not generally the case for financial institutions such as banks. In this respect, the OECD Model Convention states that there is good reason for this exception because making and receiving loans is closely related to the ordinary business of such an undertaking.

3.2.5. *Bank Levy*

34. **Methodology.** Although not specifically addressed in the questionnaire for this Study, we asked our contacts in the 27 Member States and the four third countries whether a bank levy applies in their country. If so, we asked them to briefly explain how it is calculated (tax rate, taxable base, etc.).

The detailed answers to this additional question are to be found in the different country responses to the questionnaire enclosed. In addition, we include relevant brief comments in the table summarising our answers to the first set of questions in Enclosure 1.

35. **Principles.** A bank levy or bank tax is to be interpreted as an additional tax imposed on financial institutions, predominantly banks. Following the recent financial crisis, several countries (of which certain countries in scope of the current study) have taken legislative initiative in this respect, such as an additional levy applicable to banks, which are considered to pose a systemic risk to the economy. Although there are current proposals and negotiations pending in this respect, up to now there is no common approach, for instance between the EU Member States, in relation to such tax. Generally such bank levies are not applied on the income/accounting result of the bank (as the case for corporate income tax), but are in principle levied on the (relevant) assets, liabilities or capital of the bank.

For such type of tax, generally no deductions, reductions, exemptions, etc. apply. Such tax thus contributes to an increase of the overall tax burden of banks as opposed to other companies. Moreover, considering such tax is in principle not in scope of double tax treaties concluded by countries, and taking into account the inconsistent approach between various countries as regards to the tax base and entities in scope (branches of foreign banks, etc.), a possible double taxation in the hands of banks with a multinational character appears a likely outcome.

36. **Difference in Treatment.** Based on the above, it can thus be concluded that, with respect to bank levies, there is a difference in tax treatment between banks and other companies, whereas with regard to the general tax rate, as mentioned earlier, the tax base and turnover taxes such difference is generally only limited.

3.3. Tax Treatment of Interest and Dividends

37. Traditionally, the core function of a bank is lending. Banks accept money from clients (deposits) and lend money to clients (lending). In such a scheme, a bank's income generally corresponds to the spread, being the margin between the interest paid (e.g. on the deposits it receives from clients, on commercial papers issued, on loans, on bonds, etc.) and the interest

rate it charges on money lent to clients. Over time, banks have also acted as important investors, also deriving income from various types of financial instruments.

Hence, one of the main components of the income statement of a traditional bank are generally (i) interest paid, (ii) interest received, (iii) dividends received and (iv) gains and losses realised on investments.

3.3.1. *Tax Treatment of Interest*

3.3.1.1. Corporate Income Tax Treatment of Interest Paid by Banks

38. **Deductibility.** Generally, interest paid by all companies, including banks, is tax-deductible.

However, in certain countries, deductibility may be subject to certain limitations set by thin capitalization rules or anti-avoidance rules, where these rules apply to banks (see our comments above, 3.2 'Specific tax regime applicable to banks').

3.3.1.2. WHT Treatment of Interest Paid by Banks to Third Parties

39. **Absence of WHT.** Certain countries do not provide for a general WHT on interest payments. Such is the case in Cyprus, France, Hungary, Luxembourg, the Netherlands and Sweden. Also in Estonia, a WHT is only due in the case of excessive interest payments.

40. **WHT on Interest Payments.** In principle, for all other countries, interest payments are subject to a WHT of which the rate varies from 5% (in Latvia) to 35% (in Switzerland). We refer to Enclosure 3 for an overview table of the summarising the statutory WHT rates applicable to interest payments in the survey countries. This overview table does not reflect reduced rates and/or exemptions under double tax treaties/domestic legislation.

41. **Exemptions/Reductions.** As mentioned above, overall WHT exemptions or reductions may be provided by domestic law, double taxation treaties, etc. It is not the purpose of this Study to enter into the details and mechanics of all these WHT exemptions since, given the diversity and complexity of all these rules, it would required a study as such on this topic. That being said, these exemptions mainly depend on various parameters:

- The capacity of the debtor, i.e. bank (Such is the case e.g. in Denmark, Germany, Slovenia (except in the case of payments to tax havens) and the UK (except for payments to UK individuals));

- The capacity of the beneficiary, i.e. a non-resident beneficiary (such is generally the case e.g. in Finland, Lithuania and Malta) or a bank (such is the case in Belgium or in France for instance);
- The location where the bank account of the beneficiary is open (such is the case in France for instance);
- The nature of the underlying asset;
- Etc.

42. **Specificities.** In the following countries, we have noticed the following specificities.

- In Germany, a specific exemption from the obligation to withhold tax on interest payments (so called "bank privilege") is applicable in cases of German domestic interbank loans;
- In Slovakia, no WHT applies on interest received by a Slovak or Slovak non-resident bank from deposits on bank accounts;
- In Slovenia, interest paid by Slovene banks is not subject to WHT unless paid to tax haven countries;
- In the UK, there is a general exemption for a bank making interest payments in the ordinary course of its business to a company (on payments to individuals withholding may be required). UK withholding tax does not apply to interest on an advance from a bank if that bank is within the charge to Corporation tax as respects the interest. However, there is also a general exemption from the requirement to withhold on interest payments between UK tax resident companies;
- In Singapore, the government has granted a remission of withholding tax on all interest and related payments made by approved banks in Singapore to their overseas branches, head offices or another branch outside Singapore. Based on the recent Singapore budget, it was announced that with effect from 1 April 2011, the banks and certain financial institutions will be exempted from withholding tax on interest and related payments made to all non-residents (other than permanent establishments in Singapore) so long as these payments are made for trade or business purposes. This exemption is for such payments made during the period 1 April 2011 to 31 March 2021;
- In Switzerland, interest paid by a Swiss bank is in general subject to Swiss WHT, however, there is an exemption for interest paid by a Swiss bank to another (Swiss or foreign) bank.

3.3.1.3. Corporate Income Tax Treatment of Interest Received by Banks (as Beneficiary) on Advances and Debt Securities of All Kinds

43. **Taxation.** Interest received – whether on advances or debt securities of all kinds – is generally included in the taxable profits of all companies, including banks. As already

mentioned, none of the countries surveyed reported that interest income could benefit from a more-favourable tax treatment in deviation from this principle.

44. **Timing of Taxation.** It should be noted that the timing of taxation of interest income on debt securities may depend on different factors. For instance, whether the security is used for hedging, lending, trading or other purposes. The timing of the taxation of interest depends on the specific kind of the security and should be determined on a case-by-case basis. As a result, in answering the question regarding the taxation of interest, most countries only dealt with interest payments made on 'regular' advances (loans).

45. **Accrual Basis.** Generally all the countries report that interest income is recognised on an accrual basis from a tax perspective (in conformity with the applicable accounting rules). Interest is thus recognised in the accounting period to which it relates/in which it is earned, irrespective of when it is actually received. Having said this, there are circumstances in which interest income is not accounted under the accrual basis, which in turn has an impact on taxation (because in most countries tax treatment is based on the accounting treatment). For instance, in Malta, interest may possibly be taxable on a cash basis in specific circumstances (i.e. when interest income is not recognised as trading income). In some countries, interest will generally be taxed on a cash basis (Poland).

46. **Banks v. Other Companies.** In relation to this question, no significant differences were reported between the applicable tax treatments in the hands of banks as opposed to other companies.

3.3.1.4. WHT on Interest Payments Made to Banks

47. **Payments to Resident Banks.** Almost all the survey countries report that no WHT applies on interest payments made to a resident bank.

48. **Specificities.** In the following countries, we have noticed the following specificities.

- In Germany, as already explained, a specific exemption from the obligation to withhold tax on interest payments (so called "bank privilege") is applicable in cases of German domestic interbank loans;
- In Greece, interest paid by Greek residents to ordinary Greek companies is subject to a 20% WHT (as securities income). There is a WHT exemption for interest paid to Greek banks which is based on the characterization of the interest as ordinary business income for the banks;
- In Poland, no specific regime for banks in the domestic tax regulations exists. However, specific regulations, in particular WHT exemptions, on interest paid to banks exist in some of the double tax treaties concluded by Poland;

- In Portugal, interest paid to a company is generally subject to WHT, while interest paid to a resident bank is exempt from WHT. However, WHT is a mere payment on account for residents, so the final tax burden will be the same;
- In Singapore, interest payments made to a Singapore branch of a foreign bank will not be subject to withholding tax if the recipient has obtained a relevant waiver from the Singapore tax authorities;
- In Switzerland, as already explained, interest paid by a Swiss bank is in general subject to Swiss WHT, however, there is an exemption for interest paid by a Swiss bank to another (Swiss or foreign) bank.

49. **Payments Made to Non-Resident Banks.** In case of interest paid to a non-resident bank, many countries report that no WHT is due. However, this is often subject to additional conditions. In Belgium, the bank must be established in a country of the European Economic Area or with which it has concluded a double tax treaty. In France, the bank must not be located in a Non Cooperative State or Territory. In Germany, a WHT of 26.375% is only applicable if the interest is paid by a German bank to a foreign bank and the interest or the underlying loan facility is collateralized with German real estate or German ships.

50. **Double Tax Treaties and Interest – Royalties Directive.** Furthermore, in the countries where a WHT on interest applies, many countries reported that an exemption or reduced rates resulting from double tax treaties or from the implementation of the Interest – Royalties Directive may apply.

3.3.1.5. WHT Treatment in a Triangular Situation

51. **Triangular Situations.** Under this Section, we comment whether there is a WHT due by the head office of a bank (situated in a given survey country) in case a foreign branch of that bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party.

52. **Absence of WHT.** In case a foreign branch pays interest to a third party (on a debt which is borne by said foreign branch and is thus not allocated to the head office), all countries have reported that no WHT should be levied by the head-office. Indeed, in order to determine whether domestic WHT is due, all the survey countries refer to the source-state principle.

3.3.2. *Tax Treatment of Dividends*

3.3.2.1. Corporate Income Tax Treatment of Dividends Paid by Banks

53. **Dividends Paid.** Contrary to the interest payment, dividend payments/distributions are not deductible in the hands of the distributing company because this concerns an allocation of taxable profits.

3.3.2.2. WHT Treatment of Dividends Paid by Banks

54. **Scope.** The applicable WHT on dividend payments that have been examined are the applicable (if any) WHT on dividend payments made by a bank (this does not cover the domestic WHT applying to banks as recipients of dividend income).

55. **Absence of WHT on Dividend Payments.** Certain countries do not provide for a WHT on dividend payments. Such is the case in Malta, Singapore and the UK.

56. **WHT on Dividend Payments**. In principle, in most other countries, dividend payments are subject to a dividend WHT. We refer to Enclosure 4 for an overview table summarising the statutory dividend WHT rates applicable in the survey countries. This overview table does not reflect reduced rates and/or exemptions under double tax treaties/domestic legislation.

57. **Exemption Provided by the Parent-Subsidiary Directive.** Overall, all the European countries also cite the possibility of an exemption from dividend WHT based on the European Parent-Subsidiary Directive as generally incorporated into domestic legislation.

58. **Other WHT Exemptions/Reductions.** In addition, most countries also mention that an exemption or a reduced WHT rate can also be claimed for dividends paid based on double taxation treaties or local legislation and taking into account the specific facts and circumstances of the case.

59. **No Differentiated Treatment.** Generally, there is no major difference in the survey countries in the WHT treatment of dividends distributed by local banks and those distributed by local standard companies.

3.3.2.3. Corporate Income Tax Treatment of Dividends Received by Banks

60. **General Rule.** For dividend income, as for interest income, the general rule seems to be that the dividend income is taxable in the hands of the recipient.

61. **Relief Provided by the Parent-Subsidiary Directive.** However, most, if not all, European countries also allow the possibility of relief for dividend income (either via an

exemption or a tax credit system) based on the European Parent-Subsidiary Directive as implemented into domestic legislation. Although this relief is also generally applicable to banks, due to the fact that it is often subject to a minimum holding period and a minimum holding requirement, it does not generally apply to dividends from trading assets or portfolio shares.

In line with this, certain countries specifically state that dividends received on trading assets are taxable (such is the case for Denmark, Germany, the UK and Singapore for instance).

62. **Third Countries.** For most of the non-EU countries surveyed, i.e. China (in the case of foreign dividends), Switzerland and the USA, it appears that dividend income is taxable and generally subject to the domestic corporate income tax rate. Taxation of dividend income may also be reduced in those countries through a foreign tax credit regime, participation relief or other exceptions or deductions.

In Singapore, an exemption is available for foreign dividends received by Singaporean-resident companies. This exemption is not available for Singaporean branches of foreign banks.

63. **No Differentiated Treatment.** Overall, with respect to dividends received, we have not identified any important differences between banks and companies active in other sectors.

3.3.2.4. WHT Treatment of Dividends Received by Banks

64. **Same treatment.** In general, dividends paid to banks and dividends paid to companies in other sectors are treated the same way for WHT purposes. We refer in this respect to the section above on "WHT Treatment of Dividends Paid by Banks".

3.3.3. *Conclusion*

65. **No Significant Differences.** Overall, regarding the corporate income tax treatment of interest paid/received and dividends paid/received, there are no apparent significant differences in treatment between banks and other companies.

66. **WHT.** On the other hand, countries with a WHT on dividends and/or interest generally also provide a range of exemptions dependent on: (i) the capacity of the debtor of the income, (ii) the capacity of the recipient of the income, (iii) whether the payment is made to a resident or a non-resident, etc. In this respect, we do not observe any uniform approach or universal principle among the survey countries. Nevertheless, in some of the survey countries, banks can benefit from a broader range of WHT exemptions, especially for interest payments.

We refer to Enclosure 5 for an overview table of the WHT treatment of interest and dividends paid to banks is described, as well as the differences applicable to banks, where relevant.

3.4. Tax Treatment of Gains and Losses on Fixed Assets

67. **Scope.** As agreed with the Commission, we narrowed the scope of this question to financial fixed assets (with the exclusion of other fixed assets such as real estate, equipments, etc.). "Financial fixed assets" refer to financial assets which are not held for trading purposes, and this includes financial instruments.

For the purposes of this Study, we made a distinction between two types of financial fixed assets: shares on the one hand, other financial instruments on the other hand. In addition, a distinction has been made between the applicable tax treatment upon realised gains and losses, and upon unrealized gains and losses.

68. **Realized gains/losses on shares.** In respect to the taxation of shares which qualify as financial fixed assets, there is no consistent approach between the countries in scope. In the majority of countries, realized losses are tax deductible if the realized gains are taxable (this is the case for Austria, Bulgaria, Estonia (upon distribution only), Hungary, Latvia, Poland, Portugal, Romania, Slovenia, Spain and Singapore), and where realized losses are not tax deductible, the realised gains will in principle be exempt (this is the case for Belgium, Cyprus, Germany, Slovakia and China).

In certain countries, realized losses on shares may only be offset against gains which have a similar nature (this is for instance the case for Greece, Ireland, Lithuania and the UK). Ireland for instance, applies a so-called 'basket provision' (i.e. losses are deductible against capital gains realised during the same accounting period)

In other countries, the deductibility of the realized losses on shares will depend on the tax treatment which applies on the realized gains of said shares. For instance, only when realized capital gains on shares benefit from an exemption, the realised losses are not deductible for tax purposes (this is the case for the Czech Republic, Denmark, Finland, France, Italy, Luxembourg, Malta, the Netherlands, Sweden and Switzerland). Luxembourg, Sweden and Switzerland for instance cite an exemption provided the conditions of the participation exemption regime/participation relief are complied with (generally, a minimum holding period and minimum holding requirement). In Belgium, capital losses on shares are in principle not deductible even if the participation exemption conditions are *not* met.

In Malta, capital losses can be carried forward indefinitely to future years and absorbed against future capital gains. For the sake of completeness, in China, losses are only deductible if

supported by a special purpose report. In Singapore, there is no tax on capital gains (and capital losses are not deductible).

69. **No Separate Capital Gain Tax.** In general, the countries do not report a separate capital gains tax. However, in Ireland, capital gains are taxed at a rate of 25% (compared to the 12.5% applying to trading income).

70. **Realized Gains/Losses on Other Financial Fixed Assets.** In respect to the taxation of other financial fixed assets (not shares), the countries in scope have a more consistent approach whereby realized losses are usually deductible for tax purposes, and realized gains are taxable.

71. **Unrealised Gains and Losses.** With respect to the tax treatment of unrealized gains and losses, we refer to the table contained in Enclosure 6. Compared to the non-Financial Sector, few countries identified differences in the tax treatment of financial fixed assets. The differences mainly relate to unrealized gains and losses being recognized for tax purposes in the banking sector (this is the case for Bulgaria and Sweden).

72. **Overview Table.** We refer to Enclosure 6 for an overview table of the tax treatment of gains and losses on financial fixed assets, as well as for the differences applicable to banks, where relevant.

3.5. Tax Treatment of Some Financial Practices/Instruments

3.5.1. *Discounts on Government Bills, Trade Bills and Similar Instruments*

73. **Scope.** For the purpose of answering this question, 'discounts' are understood as being the negative difference between face value and acquisition price of government bills, trade bills and similar instruments.

74. **No Differences.** Given the purpose of the questionnaire, none of the countries reported a difference in the treatment of such income in the hands of banks as opposed to other companies.

75. **Accrual Basis.** Generally, such income is recognised on a *pro rata temporis* basis until maturity, i.e. an accrual basis. From a tax perspective, the income is thus generally taxed on an accrual basis.

76. **Exceptions.** A limited number of countries provide that such discounts are taxable in the hands of the holder upon maturity, redemption or sale of the bill (this is the case for Germany and Poland for instance).

3.5.2. *(Financial) Assets for Trading Purposes*

77. **Scope.** For the purposes of this Study, we made a distinction between two types of financial trading assets: shares on the one hand, other financial instruments on the other hand. In addition, a distinction has been made between the applicable tax treatment upon realised gains and losses, and upon unrealized gains and losses.

78. **Taxation of Gains / Deduction of Losses.** In most countries, capital gains on trading assets are taxable whereas capital losses are tax deductible. In some countries, like for instance Belgium, Cyprus, France, Germany, Luxembourg and the Netherlands capital gains on shares may be tax exempt under certain conditions (a 95% exemption with respect to Germany and France).

79. **Unrealised Gains and Losses.** The tax treatment of unrealised gains and losses strongly varies from country to country and depends from the applicable accounting treatment (which we do not address in this Study).

Said accounting treatment has essentially an impact on the timing of recognition of these unrealised gains and losses and can lead to differences between banks and other companies.

For instance, in Bulgaria, unlike other companies banks recognize for tax purposes both realized and unrealized capital gains / losses (revaluation income / expenses are recognized in the period when incurred).

In Germany, financial instruments held-for-trading by a bank or a financial institution are measured at fair value since 2010. Therefore, unrealized gains and losses increase or decrease the taxable income and realized gains and losses on shares as financial trading assets increase or decrease the taxable income (i.e. the 95% tax exemption is not applicable in case of shares held by a bank or a financial institution as trading assets). Correspondingly, losses resulting from a disposal of such shares are recognized for taxation purposes. The same kind of tax treatment applies in Malta.

80. **Overview Table.** We refer to Enclosure 7 for an overview table summarizing the tax treatment of financial trading assets, as well as the differences applicable to banks, where relevant.

3.6. Tax Treatment of Bad or Doubtful Debts on Advances and Loans

81. **Definitions.** In our analysis of the input provided by the survey countries, we noted that general and specific provisions are not always interpreted uniformly due to differences in tax culture and jargon.

To compare the different rules and for the purposes of this Study, we therefore defined a general provision to be one determined on a global basis, based on a statistical approach, etc., without relating to specific identifiable bad risks/debts on advances and loans.

A specific provision is deemed to be (i) a specified provision – as opposed to a general provision, or (ii) a provision specifically available for banks.

3.6.1. *General Provision*

82. **Non-Deductibility.** Bearing in mind the meaning of general provisions as described above, the majority of the survey countries indicate that they are not tax-deductible.

83. **Particular Provisions for Banks.** Apart from this common approach, a limited number of countries consider a general provision, determined as a certain percentage of total outstanding debts/loan portfolio, as deductible, i.e.:

- In Czech Republic, there are special tax rules for creation of bank provisions against non-statute-barred receivables from credits. Banks may in the given year create tax deductible provisions up to 2% of all loan receivables towards these receivables (incl. accrued standard interest). The 2% is annual average balance calculated at the end of each month and 1 January. Only loans granted to EU companies are included into the base of 2% calculation and only to these loans tax provision may be created;
- In Finland, depository banks and other credit institutions are entitled to make a tax deductible doubtful debt provision annually. This provision cannot exceed 0.6% of the amount of total receivables outstanding at the end of the tax year. Other restrictions apply as well. Further, the amount of the annual provision together with provisions made in previous years cannot exceed 5% of the amount of outstanding receivables at the end of the tax year. If the provision exceeds the maximum in any one year, the excess is regarded as chargeable income for that year. In addition, depository banks and credit institutions may include e.g. loan/client specific provisions in certain cases in the general provision (within the limits of the general doubtful debt provision);
- In France, the French Tax Code entitle banks and credit establishments to deduct a specific provision for default risks over middle and long terms loans granted. In addition, a specific practice recognised by the French Tax Authorities allows bank establishments to maintain the tax deductibility of certain accounting provisions related to assets (classically loans, bonds, notes) held in risky jurisdictions ("*provision pour risque pays*"). The deductibility of the provision is limited to a certain percentage of the assets' value held in a risky jurisdiction ranging from 0.5% to 5%;

- In Germany, general provisions may be recorded based on experienced data of the past. As a general rule, a minor provision of 1% or 2% should always be acknowledged for tax purposes;
- In Greece, banks are entitled to deduct a general provision for tax purposes at a rate of 1% (or 2% for investment banks) of their annual average advances;
- In Italy, for banks, the amount of bad debt provisions accounted on the balance sheet that are not covered by insurance and that arise from lending to customers are deductible in each period up to 0.3% of the value of the credits accounted on the balance sheet plus write-offs recorded during the financial year. For other companies, bad debt provisions are deductible in each period within the limit of 0.5% of the total nominal value of credits. Total provisions can't exceed 5% of total nominal value of credits;
- In Lithuania, banks are not subject to specific requirements applied to other companies from non-financial sector. Specific provisions for bad debts recorded by banks may be deducted to the extent allowed by the rules of the Bank of Lithuania. There is no requirement that debt should be included into income in previous periods for banks. Also there is no requirement to obtain specific evidence for banks;
- In Luxembourg, risk and charges, lump-sum and AGDL provisions are specific to banks due to their activity and inherent risks. Risks and charges provisions booked are in principle tax deductible as the loss is clearly identified and either likely or certain to occur but uncertain as to the amount or to the date. Besides, country risk provisions reflecting the temporary risk of recovery due to economic/political situation of the country of the debtor are also tax deductible. A lump-sum provision for risk-weighted assets could also be booked by the banks and is tax deductible if it meets certain conditions (i.e. limitation to 1.25% of the qualifying risk weighted assets). The AGDL ("Association pour la Garantie des Dépôts Luxembourg") provision booked is also tax deductible;
- In Poland, for banks only, a general risk provision set up in accordance with Polish accounting standards, i.e., generally, a maximum of 1.5% of all outstanding loans, should in principle be tax-deductible;
- In Spain, general provisions are not tax-deductible as a rule. However, in general terms, banks can deduct the annual charge of these provisions up to the limit of 1% of the positive difference from qualifying loans granted in the year;
- In China, the general provision is tax-deductible for banks only up to 1% of the permitted scope of loan assets, subject to a special formula;
- In Singapore, with the introduction of FRS 39, general and specific provisions for bad or doubtful debts will no longer be made. Banks which do not have a robust loss estimation process and are unable to provide for collective impairment under FRS 39 are required by the banking regulator to maintain a certain level of impairment provisions. As a concession, the amount of general provisions (computed based on a provisional formula provided in the

tax legislation) will be deductible. An auditor's certification is required to support the deduction claim.

3.6.2. *Specific Provisions*

84. **Deductibility.** Overall, in order for a provision to be tax-deductible, the majority of the survey countries require the provision to be linked to identified losses to a minimum extent, taking into account *inter alia* the probability of a certain loss, the aging of loan, payments in arrears, etc. In this respect, two countries, Spain and Switzerland (for the canton of Zurich), provide that the deductibility of such specific bad-debt provisions is generally more restrictive for banks than for other companies.

On the contrary, Portugal reported that the conditions of tax-deductibility of specific provisions are less severe for banks than for companies of other sectors, since for banks the aging of the debt is normally lower than in other companies. In the USA, too, the deductibility of specifc provisions against debt obligations is severely limited for companies other than banks.

Certain countries specify the probability of the loss by linking the percentage deductibility to the period over which the payment is overdue (such is the case in Slovakia for instance) or by requiring documentation to evidence the 'loss' of the loan (such is the case in Poland and Belgium for instance).

In the case of specific provisions, too, certain countries limit their deductibility on the basis of a certain percentage or type of loan portfolio (such as China for instance) or other parameters such as the bank's profits (such as Germany for instance), etc.

85. **General Credit Risk Provision.** In addition, certain countries also report the possibility of a provision specific to the banking sector (general credit risk provision). Overall, such specific provisions are generally recorded in accordance with special regulations and are generally considered tax-deductible in the amount stated therein (such is the case in Greece, Lithuania, Luxembourg, and Romania for instance). Some of these have already been commented above in the section regarding the general provisions.

86. **Overview Table.** We refer to Enclosure 8 for an overview table of the tax treatment of bad and doubtful debts.

3.7. Tax Treatment of Employee Stock Option Plans

87. **No Special Tax Treatment.** Generally none of the countries cited any special tax treatment for stock option plans granted by banks as opposed to other companies.

88. **Deductibility Conditions.** The majority of the countries stated that whether payments in relation to stock option plans granted by banks are deductible depends on their tax treatment in the hands of the employee. Certain countries specified in this respect that deductibility is subject to certain conditions (such is the case with Estonia, Germany, Ireland, Malta, Slovenia, Sweden, the UK and Singapore for instance. On the contrary, this is for instance not the case in Austria), generally these conditions relate to:

- Taxation of the fringe benefit in the hands of the employee;
- Reporting requirements;
- Whether the costs are actually incurred (not in the case of a capital increase).

89. **Non-Deductibility.** Based on the input provided, these costs are not deductible for corporate income tax purposes in Denmark, the Netherlands and Slovakia.

90. **Unclear Position.** Finally, a limited number of countries, i.e. Estonia, Italy, Lithuania and China, state that their tax law leaves it unclear whether such costs can be considered as tax-deductible. Nevertheless, they say that there are arguments for claiming tax-deductibility, i.e. in relation to taxation in the employees' hands.

91. **No Deduction of Capital Losses on Shares.** In Belgium, payments in relation to stock option plans are deductible, except for capital losses on shares.

3.8. Specific Questions Regarding Banks

3.8.1. *Under/Over-Estimation of Book Value – Accounting Discretion*

92. **No Specific Comments.** Overall, the majority of the countries do not provide any specific comments on this question. In general, there is no difference in treatment of banks as opposed to other companies. In addition, this question relates more to applicable accounting standards than a tax issue.

93. **Exceptions.** Only an isolated group of countries report possible differences in treatment in relation to this question:

- In Austria, the law contains two provisions regarding the discretion to under-/overstate the book value of capital, i.e. (i) in relation to claims of credit institutions, securities (except for portfolio assets), loans an advances where necessary for reasons of prudence in the light of particular banking risks, and (ii) in the case of the fund for general banking risks. These accounting discretions do not qualify as tax-deductible;
- In Germany, credit institutions have the option of capitalising receivables, bonds, fixed-interest securities and other non-interest-bearing securities at a lower value than the value

according to German GAAP as far as this is deemed necessary to protect against specific risks resulting from the credit institution's line of business. However, this does not entail any tax consequences.

3.8.2. *Difference in Treatment Between Subsidiaries and Branches*

94. **No Differences.** From a tax perspective, almost none of the countries report a difference in treatment between banks incorporated as local subsidiaries and local branches of foreign banks.

For the sake of completeness, Romanian tax law does not set down any specific rules regarding the deductibility of provisions in the case of branches. Therefore, it is assumed that (contrary to the case with subsidiaries) credit risk provisions set up according to internal group policy or IFRS should be allowed.

3.9. Practice

95. **No Specific Comments.** Generally, none of the countries report any current practice deviating from the statutory provisions.

For the sake of completeness, and as explained above, Portugal specifies that, although not explicitly provided for in its tax law, due to the specific nature of their financing activities, branches may deduct interest paid on loans received from their head office, which is not so for other branches.

4. CONCLUSION

96. **No Major Differences.** We found no evidence that banks have a significantly lower or higher corporate income tax burden than companies active in other sectors. As a general rule, the applicable standard corporate tax rate (including any municipal rates), computation of the tax base, deductible items or tax reliefs and so forth are generally the same for banks as for companies active in other sectors. There may be some differences specific to the bank business, but *prima facie* these differences do not appear significant.

97. **Specificities to the Bank Sector.** The differences are either justified by banks' particular business model or by the fact that they are regulated bodies given their central role in the economy. Differences such as the tax treatment of provisions on doubtful debtors or loans, the deduction of interest in branch structures, the taxation of financial instruments, as well as the fact that certain anti-abuse provisions, such as thin-capitalisation rules, are inapplicable or less-stringently applied to banks compared to other companies in certain countries, does not appear

to constitute favourable tax treatment for banks. Indeed, it would appear merely to be a consequence of the fact that banks operate a unique type of business and are regulated companies already subject to strict rules in terms of capital adequacy requirements.

98. **No ETR Exercise.** In the present Study, we have not performed any exercise to analyse whether the effective tax rate on banks is or might be significantly lower or higher compared to other categories of taxpayers.

99. **Code of Conduct.** Concerning this last aspect, it is worth mentioning a recent report from the OECD Forum on Tax Administration ('FTA') relating to a 'framework for a voluntary code of conduct for banks and revenue bodies'. This Framework is based on previous OECD reports (OECD 2009: Building transparent tax compliance by banks, OECD Paris; and OECD 2008: Study into the role of tax intermediaries, OECD Paris) and describes an enhanced relationship between revenue bodies, large taxpayers and their advisers, which is a collaborative relationship anchored more on mutual trust than enforceable statutory obligations. These reports identify a number of principles that could serve to guide the relationship between banks and revenue bodies, such as that (i) banks should not become involved in aggressive tax planning either on their own behalf or in their capacity as tax intermediaries, and they should consult with revenue bodies where there is significant uncertainty, (ii) banks and revenue bodies should work towards a common view of what constitutes acceptable or unacceptable tax planning. In this respect, both South Africa and the United Kingdom have introduced measures aimed at improving the relationship with their banking sectors. The UK introduced a Code of Practice on taxation for banks on 9 December 2009. The aim of the Code is to ensure that banking groups operating in the UK comply with the spirit, as well as the letter, of the law when it comes to tax matters. This initiative is to be seen in the context of the UK tax authorities' continuing drive to improve relations with large business.

100. **Bank Levies and Compliance Costs.** Although not part of the questionnaire as drafted, and not therefore the prime purpose of the study, we felt it useful, in order to give an objective overview of taxation of the Financial Sector, to mention that, in many countries, bank levies have recently been proposed or are to be proposed in the near future. They vary from country to country (in terms of the perimeter of the levy, taxable base and rate), but in most cases are based on concepts and principles taken from the 2010 IMF report on a 'fair and substantial contribution by the Financial Sector'. Also, as such levies are currently introduced or being proposed in different jurisdictions without any consistent approach, multinational banking groups may be subject to a double imposition of tax for which currently no relief is possible under double taxation agreements, etc. Due to the fact that for such type of tax generally no deductions, reductions or exemptions, etc. apply, such taxes may thus have an impact on overall taxes borne by banks as opposed to other companies. In addition, banks are playing a

central role in collecting taxes on behalf of Governments and in reporting tax information which entails significant compliance costs. In our view, this has also to be taken into in assessing the tax treatment of Financial Institutions in general, and banks in particular.

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CHAPTER 2: VALUE-ADDED TAXATION OF THE FINANCIAL SECTOR

1. PURPOSE AND SCOPE OF THIS CHAPTER

101. As already mentioned, the scope of this Study encompasses delivery of a review of current tax provisions directed at the Financial Sector and financial instruments in the EU's 27 Member States as well as – for comparison – some significant third countries.

102. More specifically, this Chapter covers the following questions:

1. For EU Member States, article 135(1) of Directive 2006/112/EC applies, which exempts financial services. Do similar provisions apply to the other, key third countries for VAT, sales taxes or consumption taxes of the same nature?
2. Do EU Member States use article 137(1)(a) of Directive 2006/112/EC to allow taxable persons a right of option for taxation of financial transactions referred to in points (b) to (g) of article 135(1), and if so to what extent? Do third countries have similar provisions?
3. Have EU Member States introduced taxes to specifically compensate for the general tax exemption for the Financial Sector (e.g. DK, FR payroll taxes, DE has a tax on insurance contracts similar to VAT but not allowing for deduction of input VAT, stamp duties, Contracts for Difference, etc.)?

103. The scope of this Chapter includes an overview together with a high-level description of the scope and application of the taxes identified but does not include detailed descriptions of the specifics of each tax. Where necessary, we have added whether the tax is applicable to banks, insurance companies, credit card companies or other institutions.

104. This Chapter needs to be seen as a continuation of the study of PwC of 2006 to increase the understanding of the economic effects of the VAT exemption for Financial and Insurance Services. The report of 2006 already provided a very high-level overview of the VAT treatment of Financial and Insurance Services within EU25 and some third countries (based on a questionnaire of around 80 questions that was completed by the PwC Global Indirect Taxes Financial Services Network). The new Study provides a more profound overview of the indirect taxation of Financial and Insurance Services within EU27 (including Romania and Bulgaria) as well as for key third countries with special focus on option to tax and compensating taxes.

2. ACTION UNDERTAKEN

105. **Questionnaires Drafted.** To gather the necessary information on the national legislation of the EU's 27 Member States plus four identified key third countries, two different

questionnaires were made up, one for the EU's 27 Member States and one for the key third countries (i.e. China, Singapore, Switzerland and the United States of America) containing the questions described above. You will find enclosed the questionnaires used for the EU's 27 Member States and the four key third countries (Enclosures 10, 11 and 12).

106. **Questionnaires Sent to PwC Network.** Subsequently, these questionnaires were sent through the PwC Global Indirect Taxes Financial Services Network in January 2011 to collect the necessary data, which was received from the Network in February 2011.

107. **Data Analysis.** Based upon the input received, a more-detailed analysis, including the necessary PwC quality checks, has been done on the data, resulting in our final outcome reported below and the attached enclosures.

3. RESULTS

3.1. VAT, Sales Tax or Consumption Taxes of the Same Nature Applicable in Third Countries

108. **Key Third Countries Having Similar Exemption for Financial Services.** Of the key third countries, Switzerland and Singapore both have similar exemptions for financial services as laid down in article 135(1) of Directive 2006/112/EC. In Switzerland, it even seems that the Swiss Federal Tax Administration will be adopting the European Court of Justice's interpretation regarding intermediary services following the cases CSC Financial Services Ltd (C-453/05 of 21 June 2007) and Volker Ludwig (C-235/00 of 13 December 2001).

109. **No Sales Tax on Financial Services but Premium Tax on Premiums.** In the USA, a Sales Tax is imposed at State level on the supply of tangible items and some very specific services. None of the States imposes Sales Taxes on financial services as provided for in article 135(1) of Directive 2006/112/EC. However, many States levy a Premium Tax on the premiums received by insurance companies for insuring risk in that particular State.

110. **Business Tax in China but Uncertainty on Taxable Basis.** In China, financial services are generally subject to Business Tax (and not VAT). However, uncertainty arises with respect to the taxable basis on which Business Tax should be calculated (gross or net). The Chinese government is currently enacting a process of VAT reform, which may entail merging the existing Business Tax system into VAT.

111. **No option to Tax in Key Third Countries.** No "option to tax" regime similar to the provisions of article 137(1)(a) of Directive 2006/112/EC exists in Switzerland, Singapore, China or the USA.

112. **VAT Deduction Schemes for Financial Services Providers.** Singapore allows a VAT deduction for banks based upon a fixed rate depending on the type of licence the bank holds or based upon a standard input tax recovery formula for other financial institutions. Switzerland[1], China and the US, on the other hand, do not have real input tax recovery systems in place.

113. **Detailed Overview.** Please find enclosed a more-detailed overview of the VAT, Sales Taxes and consumption taxes regimes with respect to financial services in the four key third countries (see Enclosure 13).

3.2. Option to Tax Financial Services in the EU Member States

114. **Possibility to Opt for Taxation of Exempt Financial Transactions.** According to article 135(1)(a) to (g) of Directive 2006/112/EC, financial services are VAT-exempt. Nevertheless, article 137(1)(a) of Directive 2006/112/EC gives EU Member States the possibility to allow taxable persons a right to opt for taxation of exempt financial transactions as mentioned in article 135(1)(b) to (g).

115. **Only Option to Tax in Seven Member States.** This means that the EU Member States may at their own discretion implement the option to tax financial services, except insurance transactions. However, of the 27 EU Member States, only seven have implemented a provision for the option to tax financial services: Austria, Belgium, Bulgaria, Germany, Estonia, France and Lithuania.

116. **No Option to Tax in Other Member States in the Near Future.** Currently, no other EU Member States are considering implementing this provision in the near future. Only in Latvia and Cyprus are initial discussions on-going with regard to a future possible implementation of the option to tax. However, at this stage it is too early to say whether these Member States will finally adopt the "option to tax" provision.

117. **Option to Tax Not Limited to Financial Institutions.** In most of the EU Member States, the option to tax is not limited to financial institutions.

118. **Significant Divergences In Scope and Application of Option to Tax.** The scope and application of the option to tax diverge significantly from one EU Member State to another.

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[1] In order to reduce administrative cost the Swiss Federal Tax Administration offers insurance companies and banks industry-specific lump-sum methodologies as a partial exemption method via an administrative guidance.

119. **Divergences Regarding Extent of Option to Tax.** Austria, Belgium and Bulgaria have implemented the option to tax to a very limited extent, while other countries like Germany,[2] Lithuania[3] and Estonia[4] have implemented it for almost all exempt financial services within the scope of article 135(1) of Directive 2006/112/EC. France, on the other hand, has implemented the option to tax for all transactions relating to banking and financial activities and, in general, to trading in securities and money. However, the actual application is limited as several, specific financial services are excluded from the scope of the option.

120. **Divergences Regarding Conditions.** The specific conditions for exercising the option also differ among the relevant EU Member States.

121. **Divergences Regarding VAT Status of the Customer.** In Germany and Lithuania, the option can only be exercised if the customer is a vatable person whereas the other EU Member States do not differentiate how it can be applied on the basis of the status of the customer.

122. **Divergences Regarding Exercising of the Option.** In France, once exercised, the option applies to all eligible services. In Lithuania, the option applies to a specified group of financial services and in Belgium to all payment and receipt transactions. In Austria, Bulgaria, Germany and Estonia, the option can be exercised on a transaction-by-transaction basis.

123. **Divergences Regarding Territoriality.** There are also differences with respect to the territoriality. In general, the option to tax is not applicable to cross-border transactions or the conditions are so strict that they preclude use of the option to tax. In Belgium and France, the vatable person opting to tax will have a right to deduct VAT with respect to cross-border banking and financial transactions, even if the service is exempt of VAT in the EU Member State of the recipient.

124. **Option to Tax Not Commonly Used.** With respect to the use of the "option to tax system" by the operators (i.e. financial institutions), it seems that the option to tax is not commonly used in most of the relevant EU Member States and is certainly not widespread within the Financial Sector

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[2] Germany: implemented the option to tax for the services mentioned in article 135(1)(b) to (f) of Directive 2006/112/EC.

[3] Lithuania: implemented the option to tax for the services mentioned in article 135(1)(b) to (f) of Directive 2006/112/EC.

[4] Estonia: implemented the option to tax for the services mentioned in article 135(1) (b) to (g) of Directive 2006/112/EC.

125. **Detailed Overview Enclosed.** Please find enclosed a more-detailed overview of the option to tax regimes in Austria, Belgium, Bulgaria, Estonia, Germany, France and Lithuania (see Enclosure 14)[5].

3.3. Other Taxes Compensating for the General Tax Exemption

126. **Other Taxes on Financial Transactions But Not All Compensating.** Nearly all EU Member States have introduced other taxes on financial transactions. Nevertheless, these do not all have the goal of specifically compensating for the VAT exemption for financial services. Most taxes were already levied before the implementation of VAT. Only six EU Member States do not have any other taxes on financial services (Slovakia, Romania, Poland, Lithuania, Estonia and the Czech Republic).

127. **Specific Payroll Taxes in France and Denmark**. France and Denmark have introduced payroll taxes to be paid on salaries by employers with VAT-exempt financial or outside-scope activities. The payroll taxes are apportioned on the basis of a *pro rata* taking into account the VAT-exempt and outside-scope turnover and are clearly a VAT-compensatory tax.

128. **Insurance Premium Tax in Most EU Member States but Divergence in Scope and Application.** Nineteen EU Member States (Austria, Belgium, Bulgaria, Cyprus, Germany, Denmark, Spain, Finland, France, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Slovenia, Sweden and the UK) have an insurance premium or similar tax, a government levy on insurance contracts/companies. The scope and application of

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[5] Although not within the scope of this particular study, we would draw attention to the fact that distortions of competition in the Financial Sector within the EU 27 Member States and vis-à-vis third countries is caused not only by the divergence in application of the option to tax rule amongst Member States but also to:

- divergent interpretations of the VAT definitions of exempt financial services as stated in article 135(1) of Directive 2006/112/EC,
- divergent interpretations of ECJ case law:

e.g. ECJ (C-242/08) Swiss Re concerning the proper VAT treatment of the transfer of a portfolio of reinsurance contracts by a German reinsurer to a Swiss associate. Although the Court clearly stated that these transactions are vatable, in practice, some Member States still treat them as VAT-exempt transactions due to their conferring a broader interpretation on other VAT exemptions, while other Member States consider them as vatable. These divergent interpretations of common transactions, for example within the insurance world (such as transfers of insurance portfolios, claims-handling transactions, run-off services or insurance back-office services) create distortion of competition not only within the Member States but also vis-à-vis third countries.

- inconsistent implementation of the VAT prorate methodology between Member States;
- inconsistent implementation and interpretation of the cost-sharing VAT exemption and VAT grouping rules in some Member States.

insurance premium tax differ from one EU Member State to another. In some EU Member States, this tax is clearly a VAT-compensatory tax while, in other countries, this link cannot be made. According to the latest information, the Czech Republic may implement an insurance premium tax in 2013.

129. **Also Other Taxes and Levies on Financial Instruments.** Alongside these taxes, most countries have also implemented other taxes and levies on financial instruments/services such as stamp duties, stock exchange taxes, bank levies, special contribution taxes, government levies, registration taxes, mortgage taxes, etc. However, these taxes mostly differ from Member State to Member State.

130. **Detailed Overview.** Please find enclosed a more-detailed overview of the other taxes in the 27 EU Member States (see Enclosure 15).

131. **Recent Introduction of New Taxes in Several Member States.** Some Member States have recently introduced new taxes or have intentions of implementing new taxes or adapting existing taxes. This is the case for Austria, Belgium, Bulgaria, the Czech Republic, Greece, Hungary, Ireland, Poland, Romania and the UK.

4. CONCLUSION

132. **Taxation of Financial Transactions in Key Third Countries.** Of the key third countries, Switzerland and Singapore both have similar exemptions without credit for financial services as laid down in article 135(1) of Directive 2006/112/EC. In the USA, no sales taxes are levied on financial services. However, most States levy an insurance premium tax. In China, on the other hand, financial services are generally subject to Business Tax.

133. **No Option to Tax in Key Third Countries.** No "option to tax" similar to the provisions of article 137(1)(a) of Directive 2006/112/EC exist in Switzerland, Singapore, China or the USA.

134. **VAT Deduction Schemes for Financial Services Providers.** Singapore provides for input VAT deduction based upon a fixed rate depending on the type of licence the bank holds or based upon a standard input tax recovery formula for other financial institutions. Switzerland, China and the US do not have real input tax recovery systems in place in their tax legislation.

135. **Only Option to Tax in Seven Member States but Significant Divergences in Scope and Application.** Within the EU's 27 Member States, only seven Member States have implemented a provision for opting to tax financial services. The scope and application of the

option to tax diverge significantly from one EU Member State to another. With respect to actual use, it seems that the option to tax is not commonly used in most of the relevant EU Member States and is certainly not widespread within the Financial Sector.

136. **Other Taxes on Financial Transactions but Not All Compensating.** Nearly all EU Member States have introduced other taxes on financial transactions. Nevertheless, they do not all have the goal of compensating for the VAT exemption for financial services. The most common additional tax on financial services is insurance premium tax. Most EU Member States have also implemented other taxes and levies on financial instruments/services such as stamp duties, payroll taxes, stock exchange taxes, bank levies, special contribution taxes, government levies, registration taxes, mortgage taxes etc. However, these taxes mostly differ greatly from EU Member State to EU Member State.

137. **Recent Introduction of New Taxes in Several Member States.** Some Member States have recently introduced new taxes or have intention of implementing new taxes or adapting existing taxes.

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CHAPTER 3: LABOUR TAXATION IN THE FINANCIAL SECTOR

1. PURPOSE AND SCOPE OF THIS CHAPTER

138. The scope of this Chapter extends to identifying whether and, if so, to what extent salaries and incentive pay schemes paid to employees in the Financial Sector are treated differently for income tax, social security and any other applicable salary tax purposes than salaries paid to employees working in other sectors. It clarifies the conditions under which this differentiated treatment applies, if any, and explains its rationale. It identifies whether dividend income and capital gains on shares issued by a financial institution might be treated differently for an individual shareholder than dividend income and capital gains on shares issued by non-financial organizations.

139. The scope of this Chapter does not include a description of the tax and social security treatment of salaries and incentive pay schemes in the different jurisdictions but aims at identifying and understanding of whether and, if so, to what extent differentiated tax treatment applies to pay in the Financial Sector. The scope of this Chapter also does not include a review of pay practices, pay structures and pay levels in financial services by comparison with those applicable in other sectors. The scope of this Chapter does not necessarily address the impact that regulatory requirements specifically applicable to the Financial Sector might have on pay practices in the Financial Sector.

140. For the purpose of this Chapter, the "Financial Sector" includes banks, insurance companies, credit card companies, stock brokers and management companies of investment funds. Investment funds themselves have not been included. Investment funds are managed by dedicated management companies and are therefore generally not staffed.

2. ACTION UNDERTAKEN

141. As agreed, to ensure a consistent approach in each jurisdiction, we have prepared a questionnaire including 7 questions. This questionnaire (see Enclosure 16) was included in the contract referred to above and agreed by the Commission.

142. Further to our interim report, you have raised specific questions for Denmark, France, Ireland, Italy, Portugal and the UK in your e-mail of February 14, 2011. In addition, further to the telephone conversation of February 23, 2011, during which we discussed the way forward to the interim report, we have prepared and sent additional questions to each jurisdiction. This additional questionnaire is attached (see Enclosure 17). The aim of this additional

questionnaire was to gather information on whether pay packages in the Financial Sector include a proportion of components benefiting from favourable tax treatment (like equity incentive elements) different from the proportion of such components included in pay packages in other sectors so that the average tax burden on pay packages in the Financial Sector might be lower than in other sectors.

3. RESULTS

3.1. Identification of a Possible Differentiated Tax Treatment of Salaries and Incentives Applicable in the Financial Sector in Comparison to Other Sectors

3.1.1. *For Individuals*

143. **Identification of Differentiated Tax Treatments.** Based on the answers provided by our offices in the various jurisdictions, out of a total of 31 countries (27 EU Member States, China, Singapore, Switzerland and the USA) only 7 countries have reported having taken legal initiatives according to which salaries, bonuses, stock options, and/or other equity incentives in the Financial Sector have been, are or are expected to be treated differently from a tax perspective from those in other sectors.

Those countries are:

- France
- Greece
- Ireland
- Italy
- Malta
- Portugal
- United Kingdom

144. **Danish Special Payroll Tax.** For the sake of completeness, it should be noted, however, that Denmark reported that companies not subject to VAT (irrespective of the sector of activity) are liable to a special payroll tax of approximately 9% levied on total salaries. Board member fees are not subject to this special payroll tax. As organizations in the Financial Sector are not subject to VAT in Denmark, they are liable to this payroll tax. However this 9% payroll tax is not specific to organizations in the Financial Sector, it also applies to other organizations not subject to VAT (as of 1 January 2011, the size of the levy has been increased from approximately 9% to 10.5%). Based on the above, it therefore may not be concluded that this payroll tax only actually burdens pay in the Financial Sector, although this is effectively the case.

145. **Dividends and Capital Gains.** Furthermore, dividend income and capital gains on shares issued by companies in the Financial Sector are not treated differently from dividend income and capital gains on shares issued by companies in other sectors. Therefore, even if organizations in the financial services were to resort to equity incentives (stock options, etc.) more intensively than organizations in other sectors, the reason may not be that there is differentiated tax treatment of dividend or capital gains on shares between the Financial Sector and other sectors. Governments have not thus encouraged more intensive use of incentives, if there are any, in the Financial Sector by means of a favourable tax treatment of dividend income or capital gains on shares in the Financial Sector.

146. Below we describe the aforementioned differentiated tax treatments in these 7 jurisdictions.

3.1.1.1. France

147. France introduced a temporary 50% tax on 2009 bonuses granted to employees working in the financial trading market and whose activities were likely to have a material impact on the risk exposure of banks and investment companies. In particular, traders and sales were concerned, as well as individuals operating in the financial markets and managing traders and sales. Board members not acting in the financial markets in the course of their business were not concerned by this tax. As the tax applied only once (to bonuses paid in 2010, which were calculated on the basis of the performance of the employee in 2009), bonuses paid in 2011 on the basis of 2010 performance will no longer be subject to this tax.

148. The tax was levied on the variable part of remuneration exceeding EUR 27,500 and allocated based on individual or collective performance for the year 2009 (excluding the mandatory and voluntary profit-sharing schemes regulated by the French Labour Code). The tax was due even if final vesting of the bonus or its payment was subject to certain conditions, and the amount of the tax was not adjusted/refunded based on the actual payouts.

149. Variable compensation paid either in cash or via the grant of free shares, stock options or other securities granted under preferential conditions fell under the scope of the tax. When equity instruments were used, the fair value, as determined according to the international accounting standards (IFRS2), was used as the taxable basis.

150. It is the employer who was liable to this 50% one-off tax surcharge just as if it were a special 50% employer social security tax. This special tax surcharge was due in addition to other taxes normally applying to bonuses and was thus notably subject to individual income tax at rates of up to 41% for 2010 income.

3.1.1.2. Greece

151. According to article 14, par. 9, of the Income Tax Code, bonuses that are paid beyond regular remuneration and overtime payments up to 31 December 2013 by credit institutions to their corporate officers (chairman, members of the board of directors, managing or executive directors, administrators, directors etc.) are liable to a special tax according to the following terms and conditions. This rule applies irrespective of whether the bonus is paid in cash or in shares.

152. If the total pay of the recipient does not exceed EUR 60,000 per annum, bonuses in excess of 10% of total pay are subject to tax at the following rates:

- Up to 20,000 EUR 50%
- 20,001-40,000 EUR 60%
- 40,001-60,000 EUR 70%
- 60,001-80,000 EUR 80%
- 80,001 EUR and over 90%

153. This tax scale applies to the excess mentioned above instead of the regular tax scale, which provides for a maximum top marginal rate of 45%. If total pay exceeds EUR 60,000, bonuses in excess of EUR 6,000 are taxed based on the same tax scale.

154. As a result, bonuses paid to corporate officers of credit institutions may suffer tax at a rate of up to double the regular top marginal rate of 45%.

155. The rationale for this differentiated treatment is that it is deemed necessary to tax excessive bonus amounts paid to corporate officers of credit institutions in light of the financial crisis that Greece is currently experiencing.

3.1.1.3. Ireland

156. A 90% tax rate called the "excess bank remuneration charge" was introduced on 1 January 2011 on all emoluments/remuneration which are not regular remuneration i.e. any element of remuneration that varies by reference to performance of the business or the individual e.g. bonuses.

157. The 90% charge will apply to employees of specified financial institutions that are covered under the State Guarantee Scheme ("covered institutions") who are Irish tax-resident or who exercised the duties of their employment wholly or partly in Ireland during the tax year in which the payment was made.

158. Further to this, the "excess bank remuneration charge" has the following characteristics:

- It does not apply where the 'relevant remuneration' is less than €20,000 in the tax year;
- There are rules to determine the value of the award if it is not in cash or is subject to restrictions;
- The charge will be effected by means of the new Universal Social Charge, but at a special rate of 45% (the sum of the top income tax rate of 41%, social security of 4% and the penalty USC of 45% comes to the said 90%);
- The employer will be obliged to withhold the charge at source;
- There are various new reporting requirements.

159. To determine whether board members are considered as employees in scope of this "excess bank remuneration charge", a distinction has to be made between executive and non-executive board members.

160. While there might be some argument as to whether executive directors are caught (if they don't have an underlying employment contract alongside their directorship), it is clear from all public statements that the intention is to bring executive directors within this legislation. Furthermore, regulations are expected which will probably put that aspect beyond doubt.

161. In relation to non-executive directors, it appears they probably fall outside the legislation. However, non-executive directors are largely government-appointed to the institutions in question. Furthermore, we expect their directors' fees are not performance-related, meaning they should not be classed as 'relevant remuneration' for the purposes of this legislation.

3.1.1.4. Italy

162. According to Law Decree n° 78 dated May 31, 2010, converted with modifications into Law n° 122 dated July 30, 2010, bonuses and stock options granted to executives of companies operating in financial services will in principle be subject to a tax surcharge of 10%, applicable only to the extent that they exceed 3 times the base salary of the beneficiary. Board members are considered as executives for the purposes of this special bonus tax.

163. The Italian tax authorities have not yet issued a "guideline" providing the necessary clarifications on this recent tax rule. However, considering that the top marginal tax rate for individual taxpayers is equal to 43%, the amount of bonus and stock options exceeding 3 times the individual's base salary would be subject to a tax rate of 53% instead of 43%.

164. At this stage it is unclear whether, with respect to stock options, this excess will be measured at the grant date of the options or when the options are exercised.

3.1.1.5. Malta

165. Expatriates (as defined in the law and satisfying certain determined conditions) working in investment services[6] and insurance companies are not taxable on certain limited expenses and other emoluments for a limited period of time, e.g. removal costs in respect of relocation to or from Malta, accommodation expenses incurred in Malta, travel costs in respect of visits by the investment services expatriate or insurance expatriate and his immediate family to or from Malta. Furthermore they are treated as non-residents for certain purposes of the Income Tax Act and thus are taxed on their Maltese-source income only.

166. Expatriate employees of investment services firms holding a licence to provide these services are exempted from social security contributions provided they satisfy certain strict conditions, e.g. are engaged in a managerial capacity or in a function requiring special expertise which is not generally available in Malta, their mission in Malta is of a temporary nature and they have maintained the centre of their economic interests outside Malta. However, due to the strict conditions which are applicable, this exemption is of limited application in practice.

167. As Malta has severe restrictions and limitations of expertise in this sector, these tax concessions aim at attracting to Malta people from abroad with expertise in some specialised areas of financial services, so that they can provide the benefit of their expertise and train locals.

3.1.1.6. Portugal

168. For a long time the banking sector has had a special social security system, which was applicable under the same conditions to board members and other employees from the banking sectors and which did not provide for any limitation on the contribution basis. This regime has been adapted to bring it closer to the general social security regime.

169. Employees in the banking sector hired after March 2009 are subject to the general mandatory social security system (old age pension and disability coverage), but they still benefit from the entitlement to banking sector health assurance.

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[6] For income tax purposes, article 6 of the Income Tax Act defines *"investment services expatriate"* as: *"any individual who is an employee of, or provides services to, an investment services company which holds an investment services licence issued under article 6 of the Investment Services Act or a company which is recognised by the relevant competent authority for the purposes of article 9A of that said Act, and whose activities solely comprise the provision of management, administration, safekeeping or investment advice to collective investment schemes as defined in the aforesaid Act."*

170. As from 1 January 2011, employees in the banking sector hired before March 2009 have also become subject to the general social security regime for retirement pensions but they maintain the same level of contributions and their guaranteed rights (e.g. a pension calculated in accordance with the rules applicable to the pension fund). However, a retirement pension cannot be lower than the amount set in the collective agreement applicable to the bank sector.

171. The legislation does not say whether, as from 1 January 2011, board members in the banking sector will be enrolled in the special regime for board members or be subject to the same rules applicable to other banking employees.

172. The Portuguese social security legislation provides for a special social security regime for board members, according to which they are subject to lower social security rates and have a capped contribution basis (maximum monthly contributions basis of EUR 5,030.64).

173. Additionally, banks do not have yet guidelines on social security in relation to this issue and each bank is using the regime that it understands to be the most appropriate. Taking into consideration the impact of this issue, it is expected that the Portuguese social security authorities will take a position on this soon.

174. Since 2010, executives' and board members' variable pay in excess of 25% of total annual remuneration and EUR 27,500 has been subject to a special autonomous tax levied at a rate of 35% except if at least 50% of the variable pay is deferred over a 3-year period and is contingent on corporate performance over the deferral period. In the Financial Sector, the 35% rate has been increased to 50% effective in 2010. Since January 2011, the autonomous corporate tax has also been charged at the rate of 35% in the Financial Sector.

175. The special autonomous tax is a tax due by the employer, not by the employee. The bonus still remains subject to regular social security charges and personal income tax.

3.1.1.7. United Kingdom

176. The UK government introduced a one-off bank payroll tax of 50% applicable in 2010 on certain bonuses and other payments that met certain conditions, payable by the employer and not the employee.

177. The payroll tax was an employer's liability that came on top of the income tax due by the employee.

178. As an example, on a gross bonus of 100,

- Employer bank payroll tax = 50 (not deductible for corporation tax)
- Employer national insurance = 12.8

- Employee tax and national insurance = 41 (as generally applicable to bonuses paid when top rate of tax and employee national insurance was 41%).
- Net bonus for the employee = 59

179. This one-off payroll tax of 50% aimed to alter the behaviour of banks to get them to reduce the level of bonuses paid, which it failed to do. In general banks did not reduce the level of bonuses but paid the 50% if applicable.

180. There is no current intention to adopt a similar measure in the future.

3.1.2. *Availability of a Corporate Tax Deduction of Pay*

181. **Corporate Tax Deduction of Pay.** As we suggested in the interim report, we have investigated for each of the 31 countries whether there is differentiated corporate tax deductibility of costs of pay (for both board members and non-board members) in the Financial Sector in comparison with other sectors. This could be a determinant factor in the determination of the existence of differentiated tax treatment overall.

182. However, as we anticipated, **out of the 31 countries, each one confirmed that the costs of pay are deductible for corporate tax purposes to the same extent in the Financial Sector as in other sectors**. This is not to say that each component of pay packages qualifies for a corporate tax deduction but it does mean that the eligibility of any given component included in a pay package for a corporate tax deduction is not different according to whether it is allotted by organizations in the Financial Sector or in other sectors of activity.

3.1.3. *Conclusion*

183. **Temporary Measures.** In 2010, France and the UK introduced a one-off 50% payroll tax on certain categories of bonuses payable in organizations in the Financial Sector. This 50% payroll tax, payable by the employer, is no longer applicable. Also in 2010, Portugal laid down an autonomous corporate tax on bonuses and other variable remuneration paid to executives or board members, which was charged at the rate of 50% in the Financial Sector and at the rate of 35% in other sectors. However, since January 2011, the autonomous corporate tax has also been charged at the rate of 35% in the Financial Sector.

184. **Tax Surcharge on Bonuses.** For now, we have identified that it is only in Italy and Greece that bonuses in the Financial Sector are subject to a tax surcharge while in Ireland a 90% tax is expected to apply to future bonus payments to senior executives in the banking sector (essentially banks covered by the bank guarantee scheme), effective on January 1, 2011.

185. **Malta Incentives for Expatriates.** We have also identified that in Malta there are some tax concessions applicable to expatriates active in investment services and insurance companies for the purpose of developing these activities in Malta, while in Portugal, there are some discrepancies in the social security scheme applicable in the banking sector. At this stage it is unclear which social security regime, the general one or the one prevailing in the Financial Sector, is more favourable.

186. **Summary.** Out of a total of 31 countries only 7 have reported having adopted specific legislation for the purpose of creating a differentiated tax treatment of remuneration in the Financial Sector. Most of these legal initiatives were adopted after the financial crisis and most of them resulted in a tax surcharge being applied to bonuses. However only three, being Greece, Italy and Ireland, are still applying or are about to apply a tax surcharge on "excessive" bonuses in the Financial Sector. These three countries are those which were/are being particularly hit by the financial crisis. From a corporate tax perspective, all the surveyed countries confirmed that no differentiated corporate tax deductibility of pay-related costs applied or was expected to apply in the Financial Sector.

3.2. Identification of a Possible Favourable/Differentiated Tax Treatment of Pay Packages in the Financial Sector due to a Potential Intensive Use of Equity Incentives

187. **Absence of Specific Tax Concessions.** As stated above, except for 7 jurisdictions, no specific legal initiative has been adopted by lawmakers in the EU or other surveyed jurisdictions in order to create a tax surcharge or tax alleviation on pay in the Financial Sector.

In the 7 jurisdictions where legal initiatives were taken, they were adopted following the financial crisis to increase the tax cost burdening variable pay for the purpose of discouraging the payment of excessive bonuses that could notably incentivize their beneficiaries to take risks exceeding the general level of risk tolerated by the financial organization.

Furthermore we found no evidence that, prior to the financial crisis, lawmakers in the 31 surveyed jurisdictions adopted any specific tax concessions or surcharges exclusively applicable to pay in the Financial Sector.

188. **Impact of the Pay Structure.** As a way forward to these findings, we assessed whether assuming that pay structures in the Financial Sector do depart from pay structures in other sectors, such differences might have resulted in the Financial Sector having indirectly taken advantage of possible tax concessions applicable to specific pay components - like equity incentives.

Indeed, if the Financial Sector had aligned the design of its pay practices to the increasing expectations of its shareholders (i.e. high returns in the short term) more rapidly than other sectors by means of intensive use of equity incentives then, subject to equity incentives being eligible for specific tax concessions, one might wonder whether pay packages in the Financial Sector have to that extent been treated more favourably than in other sectors.

189. **Impact of Other Regulations.** It is also interesting to note that several regulators (notably the Committee of European Banking Supervisors (CEBS)) have recently indicated that although the causes of excessive risk-taking in the banking sector are many and complex, inappropriate remuneration structures including incentives to take risks exceeding the general level of risk tolerated by a financial institution (like stock options) could have undermined sound and effective risk management and exacerbated excessive risk-taking behaviours. Hence, on that basis, one might wonder whether tax concessions, if any, applicable to such incentives could also have indirectly exacerbated excessive risk-taking in the banking sector.

190. **Stock Options and Other Equity Incentives.** To appreciate this, we have identified the jurisdictions applying favourable individual tax treatment to stock options and other equity incentives, and whether such favourable tax treatment was conditional.

Out of 31 countries, 12 have reported applying conditional favourable tax treatment to stock options and other equity incentives (being Austria, Belgium, Denmark, Estonia, France, Ireland, Poland, Spain, the UK, China, Singapore and the USA), Malta and Romania have reported applying favourable individual tax treatment to stock options only (conditional in Romania, unconditional in Malta) while Finland and Slovenia have reported applying a conditional favourable tax treatment to equity incentives other than stock options.

191. **No Differentiated Treatment.** We further surveyed the 31 jurisdictions on whether this applicable favourable tax treatment, where applicable, was open to every sector of activity or whether there were specific tax concessions applying to equity incentives in the Financial Sector. All jurisdictions that reported applying favourable individual tax treatment to equity incentives confirmed that there was no differentiated treatment in this respect between the Financial Sector and other sectors.

192. **Use of Equity Incentives.** If we make the assumption that organizations in the Financial Sector have resorted more intensively to equity incentives than organizations in other sectors, then it might, at first sight, be speculated that, in surveyed jurisdictions that reported tax concessions that were applicable to equity incentives, the Financial Sector benefited more from these tax concessions.

However, you will recall that, in a total of 16 jurisdictions that reported tax concessions applicable to equity incentives, all, except Malta, reported that such tax concessions were conditional. In this respect, our experience is that the conditions to which such tax concessions are applicable generally require that pay-outs derived under equity incentives do not exceed a certain threshold or require that the instruments (options, shares, etc.) should be held for a minimum period of time. This is interesting to note for two reasons.

Firstly, what might in the first instance appear to be a favourable tax treatment may ultimately be fair tax treatment given the restrictions applying to equity incentives. This will specifically be the case when options may not be exercised or shares sold for an agreed period of time. In that case, the fact that the taxable amount or the tax rates might be discounted would just reflect the illiquidity of the incentive and the risk taken by the beneficiary (i.e. risk of depreciation of the share) over the agreed holding period.

Secondly, in the case where the application of favourable tax treatment to equity incentives is subject to the employee satisfying holding periods of the instruments, then such tax concessions have more likely supported a better alignment of the employee's financial interests to those of shareholders in the long run and discouraged excessive risk-taking in the short run.

Although we have not analyzed the conditions under which incentives could benefit from a favourable tax treatment in each of the 16 countries, based on our experience, it is thus very unlikely that such tax concessions have actually supported excessive risk-taking and one could even conclude that the opposite is the case.

We finally surveyed each jurisdiction on whether it was their experience that equity incentives were more intensively used in the Financial Sector than in other sectors. It was not the experience of our local offices that it was local practice but we may anticipate it could be the case.

4. CONCLUSION

193. **Legal Initiatives Taken in 7 Countries to Create a Differentiated Tax Treatment of Pay in the Financial Sector**. Based on the above, we found no evidence that, prior to the financial crisis, lawmakers in the 31 countries adopted any specific tax concessions or surcharges exclusively applicable to pay in the Financial Sector. By contrast, following the financial crisis we identified legal initiatives in 7 jurisdictions aimed at containing the level of variable pay by means of the assessment of tax surcharges. However only three, being Greece, Italy and Ireland, are still applying or are about to apply a tax surcharge on "excessive" bonuses in the Financial Sector.

194. **Conditional Favourable Tax Treatment of Equity Incentives Likely Discourages Excessive Risk-taking in the Short Run.** We obtained no evidence from our foreign offices that the Financial Sector more intensively resorted to equity incentives in its pay packages but we can speculate that it may possibly have been the case. This may be further investigated if needed. However, even if this has been the case, the mere fact of identifying that equity incentives benefit from a specific tax concession will not necessarily have led to an alleviation of the tax burdening pay in the Financial Sector given that, in almost all jurisdictions, such tax concessions are conditional. In addition, the conditions under which favourable tax treatment for equity incentives is available are generally of such a nature as to promote better alignment of the employee's financial interests and those of shareholders in the long run and to discourage excessive risk-taking in the short run.

195. **Equity Incentives Which Might to a Certain Extent Have Encouraged Excessive Risk-taking Prior to the Financial Crisis Now Expected to Discourage Such Behaviour.** It should be noted that, following the adoption of CRD III, the Committee of European Banking Supervisors adopted Guidelines on Remuneration Policies and Practices to ensure that remuneration policies and practices in credit institutions and investment firms are consistent with and promote sound and effective risk management. It is interesting to note that, under the CEBS guidelines, financial institutions hit by CRD III will actually have to intensively resort to equity incentives for the purpose of complying with deferrals and retention requirements applicable to variable pay. Equity incentives which might to a certain extent have encouraged excessive risk-taking prior to the financial crisis are thus now expected to discourage such behaviour. This shows that how a reward strategy may influence behaviour does not so much lie in the kind of instruments included in the pay package but whether appropriate restrictions and conditions apply to such instruments.

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CHAPTER 4: TAXATION OF FINANCIAL INSTRUMENTS

1. PURPOSE AND SCOPE OF THIS CHAPTER

196. The "Taxation of Financial Instruments" is the fourth Chapter of this Study. More specifically, this Chapter covers the following questions:

A. Securities transactions taxes

1. Are there securities transactions taxes on transfers of financial instruments?
2. What securities are in scope and which are exempt?
3. What are the tax provisions (reference to applicable tax section)?
4. Tax base?
5. Tax rate?
6. Is there a maximum amount of tax due?
7. Tax event? What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)?
8. Who is liable for levying the tax? Who is liable to support the tax?

B. Corporate income tax treatment of equity swaps

1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)?
2. Is there a difference if one or both of the counterparties are companies in the non-Financial Sector?
3. Are the flows of payments received taxed, if yes, when and how?
4. Are the flows of payments made tax-deductible, if yes, when and how?
5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax?
6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax?
7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain, etc.)? Does the classification depend on the nature of the underlying?

C. Corporate income tax treatment of financial futures

1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)?
2. Is there a difference if one or both of the counterparties are companies in the non-Financial Sector?
3. Are gains and losses taxed, and if yes, when and how?

4. Is mark-to-market applied?
5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax?
6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax?
7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain, etc.)? Does the classification depend on the nature of the underlying?

D. Corporate income tax treatment of call options in general

1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stock transactions (where both parties are companies in the Financial Sector)?
2. Is there a difference if one or both of the counterparties are companies in the non-Financial Sector?

E. Corporate income tax treatment of call options on stocks in the hands of the holders

1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?
2. Is there a difference if the holder is a bank/insurance company or a company active in the non-Financial Sector?
3. Is the premium paid part of the stock acquisition price?
4. Please describe the tax treatment of the gains or losses realised at the following events:
   (i) disposal of the options,
   (ii) exercise of the options,
   (iii) sale of the shares acquired through the option,
   (iv) expiration of option (without exercise or disposal)
5. Is mark-to-market applied?
6. Is there a WHT on premiums to non-residents?
7. How are the premium payments classified under the double tax treaties?
8. How are options treated when they are part of a packaged product (e.g. equity linked note)?

F. Corporate income tax treatment of call options on stocks in the hands of the writers

1. For writers, is the premium received taxable, and if yes, when and how?
2. Is there a difference if the writer is a bank/insurance company or a company active in the non-Financial Sector?
3. Is the premium received part of stock delivery price?
4. Are gains and losses upon exercise taxed?
5. Is mark-to-market applied?

G. Differentiation

For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?

H. Practices

For all the above conditions is there any information as whether actual practices may differ from legal provisions?

197. The main purpose of this Chapter is to trace differences in tax treatment in relation to securities transactions as well as some selected derivatives transactions (i.e. equity swaps, financial futures and call options on stocks) amongst the different EU Member States and selected third countries, on the one hand, and between financial institutions and "normal" companies, on the other hand. To this end, this Chapter provides a general overview of the main tendencies in tax treatment common to all countries or, where relevant, some interesting exceptions to our general observations. However, it does not exhaustively summarise and detail all of the sub-questions addressed in the questionnaire.

For a thorough, detailed overview of the applicable tax regime, rules or practice in a given country, we refer to the completed questionnaires as enclosed to this Study. In this respect, we would like to point out that the answers received in the questionnaires are high-level and not exhaustive. It goes without saying that, where derivative instruments are involved, in practice, a separate analysis should be done in each case taking into account all specific facts and circumstances.

198. Furthermore, it should be stressed that this is a taxation study. The accounting treatment of the selected derivatives is not in scope of the Study and has not therefore been examined. Therefore, we did not consult our international network with specific questions on the accounting treatment of the selected derivatives. We are of course aware that the accounting treatment of a financial instrument often plays an important role when determining its tax treatment and cannot be entirely left out of consideration. In this context, we considered it necessary to devote a few brief words to some general accounting principles that could have an influence *inter alia* on the timing of the tax treatment. Please note, however, that the insights regarding the accounting principles mentioned in this Study are merely intended to illustrate the role of the accounting treatment where derivative instruments are concerned. In this context, our comments on accounting law are for information purposes only.

2. ACTION UNDERTAKEN

199. To gather the necessary information, we sent a questionnaire with the above questions to our contacts in the 27 EU Member States and the four identified third countries. Based upon the input received, a more-detailed analysis including the necessary PwC quality checks has been done on the data, resulting in our final outcome, reported in Section 3 of this Chapter. For the sake of completeness, we also enclose the completed questionnaires.

200. Further to the additional questions raised on 18 May 2011 by the Commission in the framework of the review of the interim report, an additional questionnaire has been sent to our colleagues in the various jurisdictions.

3. RESULTS

3.1. Indirect Taxation – Securities Transaction Taxes

201. **Definition**. Securities transaction taxes can be defined as "taxes imposed on the transfer of a financial instrument/security from one owner to another". This definition shows that there should be at least a "transfer" and that this transfer should relate to a "financial instrument" or a "security" (and not, for example, real estate). Since this type of tax targets the transfer of financial instruments and not the income/gain derived from such a transfer, it can be categorised as an indirect tax as opposed to a direct/income tax. Strictly speaking, it is not the same as a registration tax, as it is not directed at registration of the financial instrument. Also, a distinction should be made between securities transaction taxes and capital duties.

202. **Countries Applying Securities Transaction Taxes**. According to the information provided, only 9 EU Member States (i.e. Belgium, Cyprus, Finland, France, Greece, Ireland, Poland, Romania and the UK) and 2 third countries (i.e. Singapore and Switzerland) apply securities transaction taxes. In addition, China applies a very specific kind of tax which can be compared to the "traditional" securities transaction taxes but cannot be considered as one as such ("business tax"). The characteristics of the tax very much differ in the countries applying it.

203. We refer to Enclosure 18 for an overview table in this regard and to Enclosure 22 for the detailed answers to the questions raised.

204. **Trade via Organised Markets**. The table in Enclosure 18 shows that only some of the countries apply securities transaction taxes when the transactions are carried out on an organised market (e.g. Belgium, Cyprus, Greece, Romania, Switzerland). In the other countries, the tax is not applicable to transactions carried out at a stock exchange (e.g.

Singapore and France) or an exemption is allowed for securities listed at a recognised stock exchange (i.e. Poland) or traded on a qualifying market (i.e. Finland). In Romania, a commission can be applied if the transaction is performed on the regulated market/alternative trading systems or a monitoring fee if it is consummated outside the regulated market. Cyprus has two types of securities transaction taxes, the first only applying to transactions effected or announced at the Stock Exchange, the second (stamp duty) allowing an exemption for securities listed at a recognised stock exchange.

205. **Type of Securities**. The securities in scope of the tax can generally be divided into three groups. In most countries, the securities transaction tax mainly applies to equities (e.g. Finland). In some countries, the tax also applies to debt instruments such as bonds (e.g. Belgium, France) or loans with equity-like features, such as convertibles (e.g. the UK). Finally, in addition to equity and debt instruments, derivative instruments (equity swaps, call options, futures) are also sometimes within the ambit of the tax (e.g. Belgium, Greece, Ireland, the UK).

206. **Type of Transfer**. In most countries, the tax is applicable, as such, to the transfer of a security in scope (e.g. Cyprus, France, Greece, Poland). However, in a least one country (i.e. Belgium) the tax is due twice on a given secondary market transaction provided that the transaction is carried out between Belgian parties (in the hands of the seller (sale) and in the hands of the buyer (purchase)). Furthermore, in that country, redemption by an investment company of its own shares is also in scope.

207. **Taxable Basis**. The basis to which the tax rate is applied is not calculated in the same way in all countries. It is often linked to the type of security or transaction/contract in scope. Usually, it is either the sales price or other consideration (e.g. Finland, France, Greece), the purchase price/remuneration for the taxable security (e.g. Switzerland), the contract value (e.g. Cyprus), the market value of the securities (e.g. Poland) or the higher of the consideration paid for the transfer or the market value of the financial instrument (e.g. Ireland).

208. **Tax Rate**. All countries apply a proportional tax rate that is relatively low. However, the rate itself varies from country to country (e.g. 0.07%, 0.15%, 0.5%, 1.6%). In addition, some countries apply different proportional rates depending on the security in scope (e.g. Belgium, Ireland) or whether the transaction is performed on a regulated market (e.g. Romania). Switzerland applies a rate of 0.15% for domestic securities and a higher rate of 0.3% for foreign securities. Also, in some countries, the rate varies between certain thresholds (e.g. Cyprus) or is only applicable when a certain threshold is reached (e.g. France). Finally, in some countries the tax is capped at a certain amount (e.g. Belgium, Cyprus 'stamp duty'), while other countries do not apply a cap (e.g. Ireland, the UK, Switzerland).

209. **Territorial Scope**. The territorial scope of the tax may depend on several factors. It could be the nationality of the transferee and/or transferor in combination with the nationality of the security. For instance, in Finland, only certain Finnish securities may be subject to transfer tax if the transferee and/or the transferor is a Finnish resident or a Finnish branch of certain financial institutions. Another example is Irish stamp duty, which can apply if there is Irish property, if the transaction is executed in Ireland or if the transaction relates to anything done or to be done in Ireland, subject to exceptions. Also, in France, the tax applies to transactions performed either in France or abroad provided the transfer relates to shares/stocks of a French unlisted company or a company mainly holding real estate located in France. In the UK as well, the tax applies on shares issued by UK incorporated companies. In Switzerland and Belgium, the connecting factor is mainly the involvement of a local intermediary.

210. **Exempt Parties**. In Belgium, an exemption exists for non-residents and the Belgian financial services sector (e.g. banks, insurance companies, organisations for financing pensions, undertakings for collective investment) acting for their own account. In other words, only Belgian tax residents not belonging to the Belgian Financial Sector are in practice subject to the tax. Also, in the UK, certain recognised intermediaries (Financial Sector traders) are given an exemption for transactions in securities. In Switzerland, foreign banks and securities dealers should *inter alia* be considered as exempt parties.

211. **Liable Person**. The different types of persons liable to support the tax can generally be summarised under either the buyer / purchaser / transferee (e.g. Finland France, Ireland, Poland, Singapore) or the seller (e.g. Cyprus, Greece). The persons liable to pay the tax to the tax authorities will generally by the intermediary/securities dealer/local stock exchange (e.g. Belgium, Switzerland, Greece, Romania). However, in some case, the parties have to declare and pay the tax themselves (e.g. Finland, France, Ireland, Poland). This is often linked to the type of transaction in scope and the territorial scope of the tax.

212. **Secondary Market Transactions**. As far as the EU Member States are concerned, attention should be paid to Council Directive 2008/7/EC of 12 February 2008 or, previously, Council Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital. This directive provides for complete harmonisation of the cases in which the EU Member States may levy indirect taxes on the raising of capital. As a consequence of this directive, only secondary market transactions can be subject to securities transaction taxes, since taxes on primary market transactions are prohibited by article 5(2) of the directive. Further to the cases of "Commission v. Belgium" (C-415/02) and "HSBC Holdings plc v. Vidacos Nominees Ltd" (C-569/07) before the European Court of Justice, Belgium and the UK had to amend their legislation regarding securities transaction taxes in this respect.

213. **Abolition**. Finally, it appears that there is a trend toward abolishing securities transaction taxes rather than introducing them. For instance, the Italian securities transfer tax has been repealed for contracts signed on or after 31 December 2008. In Greece a bill has been tabled to abolish the transaction duty on sales of listed shares initially acquired after 1 January 2012. Moreover, the Cypriot levy on transactions effected in respect of securities listed at the Cypriot Stock Exchange will cease to be of effect on 31 December 2011.

214. **Conclusion**. Only a limited number of EU Member States apply a securities transaction tax and in only part of these countries does the tax apply to transactions carried out on a regulated market. It is clear that this tax has not been harmonised on a European level. Whether or not the tax is applicable often depends on a combination of factors. The examples above also illustrate that the tax's features vary from country to country. We were able to identify three key questions that best allowed the types of tax to be sorted, namely (1) is the tax applicable to transactions carried out on an organised market? (2) which type of securities is in scope? and (3) what is the rate of the tax? Finally, we spotted two remarkable differences in treatment in Belgium and Switzerland. In Belgium the tax is not applicable to Belgian financial institutions acting for their own account, while other Belgian companies are subject to the tax. In Switzerland, a higher rate is applied to foreign securities than to Swiss securities.

3.2. Direct Taxation – Selected Derivatives

3.2.1. *Introduction*

215. **Classification of Derivatives.** The taxation of derivatives is a relatively complex matter for which there is no uniformity among the EU Member States. The complexity of this subject is mainly due to the complexity and diversity of derivative contracts themselves (and of their features), and generally not to the tax rules and principles applying to these instruments. The variety of different types of derivatives sometimes makes it difficult to classify the income and costs to which they give rise for income tax purposes.

216. **Derivatives in Scope of the Study.** For the purpose of the Study, three types of derivatives have been selected, namely equity swaps, financial futures and call options on stocks. These specific contracts can be defined as follows:

- A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. An equity swap is a swap where it is agreed to exchange a set of future cash flows between two counterparties at set dates in the future. The two cash flows are usually referred to as "legs" of the swap; one of these "legs" is usually pegged to a floating rate such as LIBOR. The other leg is based on the performance of either a share or a stock market index. This leg is commonly

referred to as the "equity leg". Most equity swaps involve an interest leg v. an equity leg, although some exist with two equity legs.

- A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short-term interest rate.
- A call option on stocks is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder), which gives the option buyer the right, but not the obligation, to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price).

Based on our experience, we note that the selected derivative contracts are not necessarily the types of derivatives representing the majority of derivative transactions performed by the Financial Sector. For example, in terms of figures, interest rate swaps and currency rate swaps are most probably more often used by financial institutions than equity swaps.

217. **Tax Provisions on Derivatives.** Most countries in scope do not have any tax provisions that specifically deal with derivatives in general and equity swaps, financial futures and call options on stocks in particular, and apply the general corporate income tax rules to these types of instruments (e.g. Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Ireland, Latvia, Luxembourg, Malta, the Netherlands, Romania, Slovenia, Spain, Sweden, Singapore, Switzerland). Some countries have embedded a few specific tax provisions or definitions in relation to derivatives or a specific type of derivative into their existing tax legislation (e.g. Greece, Italy, Lithuania, Poland, Portugal, Slovakia), such that these provisions are integrated into the body of other corporate income tax provisions. In addition, two countries, the UK and the USA, have developed a whole body of separate rules for derivatives which is very detailed and complex. Finally, as far as China is concerned, it can be noted that the Chinese tax authority has not yet issued any tax guidance with respect to swaps and that, at this stage, it is not permissible for non-resident enterprises to trade in futures or call options on stocks in China.

218. **Differences amongst Countries.** It is clear that the tax treatment of derivatives differs from country to country. Some countries even treat the same type of derivative differently depending on certain factors, for instance whether the derivative is listed or not (e.g. France, Greece) or whether the transactions are of a hedging or speculative nature (e.g. Belgium, Italy, Lithuania, Slovakia, Spain). This last distinction impels us to underline the decisive role of accounting treatment as, in the majority of the countries in scope, the tax treatment of a financial instrument is based on its accounting treatment, or is at least influenced by it.

3.2.2. *Role of the Accounting Treatment*

219. **Role of Accounting Treatment.** As mentioned above, in the majority of the countries, the starting point to determine the tax treatment of a financial instrument is its accounting treatment (e.g. Austria, Belgium, the Czech Republic, Finland, France, Ireland, Luxembourg, Spain), as tax law generally follows accounting law, unless there are derogations. Although the accounting treatment of financial instruments is not in the scope of the Study, it is impossible to assess the tax treatment of financial instruments in these countries without considering the reporting framework and some basic accounting notions and principles.

3.2.2.1. Reporting Framework

220. **Tax v. Accounting Harmonisation.** Where the taxation rules applicable to financial instruments in the EU are not at all harmonised, the accounting rules in the different EU Member States have only to some extent already been subject to a certain degree of harmonisation.

221. **EU Directives on Annual and Consolidated Accounts.** The Fourth Council Directive (78/660/EEC) was a first step towards harmonisation of financial reporting in order to improve the comparability of accounting standards and financial statements. They state the overall basic accounting and reporting principles, which form the basis of local GAAPs (generally accepted accounting principles) implemented by each EU Member State. However, translation of the general principles set down in the Directive into national law and other sources of guidance by each EU Member State does still result in differences between the various national accounting frameworks. Other directives have been issued on consolidated accounts (83/349/EEC) and annual and consolidated accounts of banks and other financial institutions (86/635/EEC).

222. **Fair Value Directive.** In 2001, the "fair value" Directive (2001/65/EC) amended the three existing directives on annual accounts (78/660/EEC), consolidated accounts (83/349/EEC) and annual and consolidated accounts of banks and other financial institutions (86/635/EEC). It required EU Member States to permit or require the application of "fair values" for certain financial instruments, including derivatives, in respect of all companies or any classes of companies.

223. **IFRS.** Regulation (EC) 1606/2002 of 19 July 2002 introduced use of the IFRS framework into the EU's accounting and financial reporting legislation. As of 2005, publically traded companies had to report their consolidated accounts under IFRS. In addition, each EU Member State had the option to extend the application of IFRS.

224. **Diversity of Reporting Frameworks.** Today the coexistence of both reporting frameworks results in a rather varied international landscape of financial reporting, where companies either report under local GAAP or under IFRS or, as in many cases, under local GAAP for the statutory accounts and under IFRS for the consolidated accounts. In addition, the use of IFRS for preparing consolidated accounts may be an option or an obligation depending on the EU Member State and a number of other criteria (quoted company v. unquoted company, financial institutions, insurance companies, etc.). Finally, in many EU Member States, local GAAP lay down specific accounting frameworks for certain regulated companies such as credit institutions and insurance companies.

225. **Different Accounting Treatment.** The ultimate accounting treatment of a specific transaction by an individual company will depend on the accounting policies laid down by it. Since the accounting frameworks do not always provide specific guidance or, in certain cases, even allow different options, a single transaction may be accounted differently by two similar companies operating in the same jurisdiction and applying the same accounting framework. Considering the different factors described above, when tax treatment follows the accounting treatment, an instrument can have different accounting treatment, and hence different tax treatment, throughout the European Union and even within a Member State.

3.2.2.2. Accounting for Financial Instruments

226. **Historical Cost v. Fair Value.** In the Fourth Council Directive (78/660/EEC) limited specific guidance was available with respect to the measurement of financial instruments and the main measurement or valuation principles referred to the use of purchase price or production cost (historical cost).

The "fair value directive" introduced the possibility for Member States to use fair value for the measurement of financial instruments, including derivatives. It also introduced the concept of hedge accounting.

This results today in a hybrid framework with differences between Member States, where historical cost (with adjustments to reflect decreases in value at balance sheet date) coexist with the use of fair value.

227. **Hedging v. Trading.** For derivative financial instruments, different accounting treatments are possible, depending on whether a derivative is contracted for hedging or for trading purposes. The different treatments will in most cases not only depend on intention but, in the case of hedging, will also depend on the effectiveness of the hedge relationship and its documentation.

The objective of hedge accounting is to avoid or reduce accounting volatility that does not reflect economic reality and is in practice achieved through different accounting mechanisms, depending on the Member State.

228. **One Instrument, Different Accounting Treatments.** The current accounting framework could result in different possible accounting treatments for a single type of financial instrument. These differences are not only driven by differences in the accounting frameworks of the different Member States (see Enclosure 23), but also by differences between statutory and consolidated accounts, differences in intention (hedging v. trading), differences between types of companies (e.g. commercial companies v. credit institutions) or even differences in the way a national framework has been transposed into the accounting policies of individual companies.

229. **Timing Differences.** These differences in accounting treatment will in most cases mainly give rise to timing differences, however. Generally, when a derivative is used for example, the valuation method used might have an impact on the company's financial position – and therefore also on its taxation – throughout the term of the financial instrument, but at maturity, when the result is realised, the accounting impact will be the same, regardless of the measurement method applied throughout the life of the instrument.

3.2.2.3. Specific Accounting Rules for Financial Institutions: Potential Impact on the Tax Treatment of Financial Instruments

230. **Specific Accounting Rules for Financial Institutions.** More than half of the countries report that there are specific accounting rules for (some of) the financial institutions in their country.

231. **Irrespective of the (Non-)Listed Status.** This conclusion applies irrespective of the listed or non-listed status of the financial institutions.

232. **Potential Impact on the Tax Treatment.** In part of the above mentioned countries, these differences in accounting treatment could lead to differences in tax treatment (e.g. Austria, Belgium, Finland, Germany, Hungary, Italy, Luxembourg, Romania, Spain, Sweden, Switzerland). In most of these countries this can be explained by the fact that the corporate income tax is computed based on the accounting framework that is applied for financial institutions (e.g. Austria, Belgium, Latvia, Luxembourg, Spain, Sweden). In almost all of these countries the difference in tax treatment consists of timing differences.

233. **IFRS.** It should be noted that in the majority of the survey countries, banks and other financial institutions generally prepare their financial statements under IFRS or local rules inspired by IFRS. Only in part of these countries the accounting treatment of financial

institutions might differ from the accounting treatment of "normal" companies. However, in most of the latter countries there is in principle no difference in tax treatment of financial instruments.

234. **Examples.** The above considerations can be illustrated by the following examples:

- In Germany there are some specific accounting rules in place for banks and financial institutions e.g. with regard to the valuation of financial instruments and with regard to accounting reserves for general risks of the banking business. However, the tax treatment might differ from the specific accounting rules e.g. the accounting reserves for general risks of the banking business are disregarded for taxation purposes. The specific accounting rules could lead to a different tax treatment of the financial instrument (differences in timing);
- Poland applies specific accounting rules for (some) financial institutions (e.g. specific accounting rules for provisions for bad debts in banks), but this does not lead to a different tax treatment of the instruments;
- In the Netherlands banks and other financial institutions mostly use IFRS, and in some instances Dutch GAAP. There are no specific accounting rules for banks and financial institutions included in IFRS of GAAP, however there are certain accounting rules that have more impact on banks than other companies and thus banks primarily focus on these rules.

3.2.3. *Mark-to-Market in Relation to Financial Futures and Call Stock Options*

235. **Introduction.** One of the questions specifically asked in the questionnaires was whether mark-to-market is applicable in the survey countries in relation to financial futures and call options of stock. When mark-to-market is applied, the price or value of a security, portfolio or account is recorded in the accounting so as to reflect its current market value rather than its book value. For a general overview of the answers received to this question, reference is made to Enclosure 19, 20 and 21.

236. **Results.** The results can be summarised as follows:

- It appears that mark-to-market is not applied in most countries (e.g. Cyprus, Lithuania, Luxembourg, Switzerland).
- In some countries like Hungary, mark-to-market is optional, but is not usually applied. In the Netherlands, assets are generally valued at cost price or the lower market value, but valuation at mark-to-market is also allowed under Dutch tax accounting principles, for both financial and non-financial players. Note that taxpayers should of course use any valuation system consistently.

- Then there are also countries where mark-to-market is not in principle applicable to "normal" companies, while financial institutions in these countries might be permitted to apply or generally apply mark-to-market valuation (e.g. Finland, Austria, Romania). For example, in Sweden, financial companies apply mark-to-market but with an option to use cost instead of fair value, provided that cost is used for all securities in the company.
- In some countries, mark-to-market is generally applied by all companies, including financial institutions as well as normal companies (e.g. Bulgaria, Germany, Malta, Portugal, Slovakia, the Czech Republic for tax residents), though exceptions may apply (e.g. the USA). For example, provided that the underlying assets are not delivered under the swap or future contract, the contract will be taxed separately in Denmark according to the mark-to-market principle. Mark-to-market also applies in Greece to futures listed at the Athens Stock Exchange.

237. **Particularities.** In some countries the line is not easily drawn between the application of mark-to-market or otherwise. For example:

- In Ireland, mark-to-market is generally applied for financial companies, where it is used for accounting purposes. For non-financial companies, taxation generally only arises when there is a disposal. Where that is not at arm's length, mark-to-market is imposed for tax purposes.
- In Austria, mark-to-market valuation has to be used if the equity swap is held in the trading book or not held as fixed assets. If it is held as a fixed asset, the lower of cost or market valuation has to be used. For hedge accounting, rules similar to IAS 39 are applicable.

238. **Non-Financial Institutions Treated Differently.** Some of the survey countries report that the accounting rules for financial institutions differ from those applied by non-financial companies, which of course could indirectly cause differences in the timing of the taxation of a derivative instrument between financial and non-financial companies (e.g. Belgium, France, Luxembourg, Slovenia, Spain). However, this difference in tax treatment can primarily be explained by the difference in accounting treatment.

239. **Mark-to-Market Is Not More Beneficial.** In this context, we do not find any indications that the tax treatment of a financial instrument is more beneficial where the mark-to-market valuation method is applied. In some cases it will be more advantageous for a company to record a profit or loss at a given time in a given taxable period while in other cases the timing might be inconvenient.

240. **Mark-to-Market Less Beneficial.** The mark-to-market is sometimes even less beneficial from a tax perspective. For instance, as an increase in the market value of a financial

instrument should be recorded in the profit and loss account earlier based on a mark-to-market valuation than on a lower of cost or market valuation (below *"LoCoM"*), the income will also be taxable earlier in countries whose tax rules follow the accounting rules. This example shows that mark-to-market valuation is not necessarily always more beneficial in comparison to historical cost or a LoCoM valuation.

3.2.4. *Tax Treatment of Payments, Gains and Losses*

241. **Common Tax Treatment.** As mentioned above, in the absence of any specific tax rules with respect to derivatives, the accounting treatment plays an important role in the majority of the countries in determining the tax treatment of the derivative instrument. Of course, there are countries in which accounting treatment is less important. Having compared the tax regimes applied by all the survey countries in relation to equity swaps, financial futures and call options of stock, it can be established that the majority more or less apply the same tax treatment to income derived from these instruments. This common tax treatment will be used to compare exceptions to the general rule or curiosities in certain countries. Note that some exceptions where there is a difference in treatment between financial companies and non-financial companies are discussed separately under section 3.2.7 below.

242. **Comparative Tables.** To be able to compare the tax regimes in the different countries, we have drawn up a table for each selected security, containing a general overview of the answers received on the basis of the questionnaires (see Enclosures 19, 20 and 21). Note that these tables are not of course exhaustive and do not include all the qualifications made in the completed questionnaires, which can nevertheless be consulted *ad longum* in the annexes. When comparing the results for equity swaps and financial futures, we noticed that the tax treatment of both financial instruments is very similar. Therefore, we discuss the tax regime of equity swaps and financial futures under the same section. Call options on stock are dealt with under a separate section, given the extra dimension caused by the payment of a premium and potential acquisition of the underlying stock.

3.2.4.1. Equity Swaps and Financial Futures

243. **Overview Tables.** The tax treatment of equity swaps and financial futures is schematically summarised in Enclosures 19 and 20. We refer to Enclosure 22 for the detailed answers to the questions raised.

244. **Common Tax Treatment.** A comparison of the tables contained in Enclosures 19 and 20 clearly shows that, in the majority of the survey countries, income from equity swaps and futures is taxable and complementary losses are tax-deductible (e.g. Austria, Belgium, Bulgaria, Denmark, France, Germany, Ireland, Switzerland).

245. **Timing.** The question is when exactly these gains are taxable or these losses are tax-deductible: on an unrealised basis (e.g. Denmark) or when actual realisation takes place (e.g. Bulgaria, Finland), on an accrual basis (e.g. Austria) or on a cash basis? By application of the prudence concept, in Latvia, unrealised gains (or losses) are non-taxable (or fiscally non-deductible), while realised gains (or losses) are taxable (or tax-deductible). As these timing differences are mainly caused by the applicable accounting treatment (see section 3.2.2 above), they are not taken into consideration in the tables.

246. **Exceptions.** There are, however, countries that do not follow this general tax treatment or for which there are some particularities of note. This can be illustrated with the following non-exhaustive examples:

- In Cyprus, income from equity swaps is not taxable, losses are not deductible. As far as futures are concerned, if the underlying assets are shares, bonds, debentures, founders' shares, other securities issued by companies/legal persons or rights thereto, then gains are exempt from income tax and losses are deductible. Otherwise, if the underlying assets are none of the above, for example futures on forex/commodities, gains will be taxable and losses tax-deductible. In other words, here the asymmetrical tax treatment of equity and debt seems to be preserved.
- In Estonia, payments received under swaps and futures are taxable, but only upon distribution. Furthermore, there is no calculation of tax losses, as only distributions are subject to corporate tax.
- In Greece, equity swaps and financial futures fall under the definition of derivatives for taxation purposes. A difference should be made between listed and unlisted derivatives. Listed derivatives are exempt from taxation, provided they are posted in a special reserve account, which can be used to offset future losses from listed derivatives. This reserve account is subject to tax upon distribution or liquidation. Unlisted derivatives, on the other hand, are subject to tax based on general provisions. Losses from unlisted derivatives are tax-deductible on condition that the transaction has been effected for hedging purposes, which means that the payments cannot be considered separately. In Greece, accounting treatment does not affect the above rules.
- In Slovakia, the general rule is that the overall loss from transactions with derivatives is not tax-deductible unless the taxpayer is a company in the Financial Sector or the transaction involves a hedging instrument. On the other hand, cumulative gains from transactions with derivates are taxable.

3.2.4.2. Call options on stock

247. **Several Consecutive Transactions.** As previously mentioned, call options on stock can be distinguished from swaps and futures because they are acquired in exchange for a premium.

A call option on stock gives the holder the right to buy certain shares for a certain price during a certain period of time. As a result, a number of different stages can be distinguished. In a first stage, the call option is issued/acquired in exchange for a premium in the hope of later acquiring shares at an advantageous price. In a second stage, the call option might be exercised to buy the shares. Finally, in a third stage, the shares itself can be sold. It is clear that the second and third stages will not always be reached. For instance, if the option is not exercised, it will expire. It is also possible to sell the option itself to another party.

For each transaction the question can be raised whether the gain or loss realised is taxable or tax-deductible. The answers received in the questionnaires are schematically summarised in Enclosure 21. Of course, for more details, reference is made to the questionnaires themselves in Enclosure 22.

248. **Legal v. Beneficial Ownership.** As a preliminary remark, it should be mentioned that options could pose difficulties for the concept of ownership. For example, in Luxembourg, for call options specific attention should be paid to determination of who the beneficial or economic owner is. Generally, the economic owner is deemed to be the legal owner. However, in certain specific circumstances, the economic owner could be different and should normally prevail for Luxembourg tax purposes. This may lead to the option being disregarded and the option buyer being directly considered as already holding the underlying assets.

3.2.4.2.1. Tax Treatment of the Premium

249. **Premium and Stock Acquisition/Delivery Price.** First of all, we focus on the tax treatment of the premium paid by the holder to the writer of the option. It appears that, in the majority of the countries, the premium paid is part of the stock acquisition price (e.g. Austria, Belgium, Bulgaria, Germany, Luxembourg, Slovenia). However, in some of the same countries, the premium does not seem to form part of the stock delivery price in the hands of the option writer (e.g. Denmark, Finland, Germany, Slovakia). In a minority of the countries, the premium is not part of either the stock acquisition price or the stock delivery price (e.g. Poland, Portugal).

250. **Holder's Deductibility Timing.** In almost all the countries, the premium is tax-deductible in the hands of the holder, but the timing of the deductibility is in most countries delayed until the time of exercise or expiry of the option. Again, reference can be made to the applicable accounting treatment, which naturally plays a role in the timing of the deductibility.

251. **Writer's Taxability Timing.** Complementary to the tax treatment in the hands of the holder, it can be said that the premium received by the writer is taxable in the hands of the writer in most countries. However, here, too, the question arises as to when exactly the

premium is taxable. Again, timing often depends on when the premium is booked in the profit and loss account. In some of the countries, the premium is taxable upon exercise or expiry of the option (e.g. Austria, Bulgaria, Finland, France, Luxembourg, the Netherlands, Slovakia), whereas, in a few countries, the premium is already taxable upon the option being issued (e.g. Denmark, Germany).

3.2.4.2.2. Tax Treatment of Exercise and Disposal of the Option

252. **Exercise of the Option.** When the option is exercised to buy shares, the question is whether the gains or losses realised are taxable/tax-deductible. It appears that there is no uniform answer to this question. Half of the countries consider the gains taxable and the losses tax-deductible (e.g. Latvia, the Netherlands, Poland, Portugal, Romania), while the other half treat the gains as tax-exempted and the losses as not tax-deductible (e.g. Austria, Bulgaria, France, Hungary, Ireland, Italy, Lithuania, Luxembourg, Slovakia, Slovenia, Sweden, Switzerland, the USA).

253. **Disposal of the Option.** As mentioned above, situations occur where the option holder might decide itself to sell the option to a third party. In the majority of the countries, gains or losses realised on the sale of the option are taxable/tax-deductible.

3.2.4.2.3. Tax Treatment of the Sale of the Shares Obtained by Exercising the Option

254. **Sale of the Shares.** Gains or losses realised upon sale of the shares are also generally taxable/tax-deductible. However, in some countries, these gains may in very specific circumstances be tax-exempted based on local rules implementing a participation exemption regime (e.g. Austria, Belgium, Denmark, France, Hungary, Italy, Lithuania, Luxembourg, the Netherlands, Slovenia, Switzerland).

3.2.4.2.4. Particularities

255. **Exceptions.** Exceptions do of course exist to the common tax treatment of call options on stock. For example, in Cyprus, based on a ruling issued by the tax authorities on a specific transaction and the general interpretation in relation to securities, the premium paid by the holder is expected to be non-deductible, while the premium received by the writer is not taxable. The premium should be regarded as part of the stock acquisition price in the hands of the holder and as part of the stock delivery price in the hands of the writer. Gains realised by the holder upon disposal or exercise of the option are exempt. Gains realised upon sale of the shares acquired by exercising the option are generally exempt, except in certain circumstances. Furthermore, no gain can arise for a holder upon expiry of the option, as the premium already paid for its acquisition is expected to be treated as non-deductible. Gains upon exercise are not taxed in the hands of the writer.

256. **Packaged Product.** Options granted into a packaged product, such as an equity-linked note, are not taken into account on a stand-alone basis for accounting and tax purposes in some of the countries (e.g. Austria, Finland, Luxembourg, Sweden). The tax treatment will generally be that applying to the main product. In other countries, they should, however, be considered as two products (e.g. Lithuania, Poland, Romania). In some countries the answer to this question is not clear. Note that, in practice, questions with respect to packaged products should of course always be analysed on a case-by-case basis (e.g. Luxembourg).

3.2.5. *WHT on Payments to Non-Residents*

257. **No WHT on Payments to Non-Residents.** The question was asked whether there is any WHT (below, *"WHT"*) on payments to non-residents originating from (i) equity swaps or financial futures, (ii) the sale of such instruments, and (iii) premiums paid to non-residents further to the acquisition of call options on stock. In the majority of the survey countries, there is generally no WHT on these payments to non-residents (e.g. Austria, Cyprus, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Sweden, the UK), unless an exception can be applied (e.g. the USA). When the source state does not levy any WHT on payments to non-residents, this is of course not directly relevant to determine the payment's classification under the applicable double tax treaty (below, *"DTT"*). We refer to the next section in this respect.

258. **WHT in Specific Cases.** In some countries, WHT can be due depending on certain circumstances (e.g. 10% in Bulgaria, 19% in Slovakia). For example, in Singapore, swap payments to non-residents may attract WHT if they are made in connection with an underlying loan or indebtedness of the payer. However, if futures are concerned, there will usually be no Singaporean WHT.

3.2.6. *Double Tax Treaties*

259. **Diverging Views.** It appears that the survey countries sometimes take diverging views as far as the DTT classification of the income generated from derivative instruments and from the sale of such instruments is concerned. Of course, each DTT is different and should be analysed on a case-by-case basis, but it appears that the classification can generally differ from country to country. Also, in some countries, there exists uncertainty in relation to the appropriate classification, and so the matter is open to interpretation (e.g. Finland). Finally, in some countries, several potential classifications could be correct, depending on the facts. We refer to the tables contained in Enclosures 19, 20 and 21 for more details. The potential classifications can be summarised as follows.

260. **Nature of the Underlying.** In some countries the classification may depend on the nature of the underlying (e.g. Austria, Ireland), while in other countries this is not the case (e.g. Slovakia, Switzerland, Portugal).

261. **Classifications.** Some countries classify payments from an equity swap or financial future as "other income" (e.g. Austria, Belgium, Slovakia). In other countries, the classification of payments from these instruments is in principle "dividend income" for income from equity swaps and "interest income" for income from futures. Moreover, there are also countries that consider these payments as falling under "business profits" (e.g. Bulgaria).

Most countries classify payments upon the sale of an equity swap or a financial future as "capital gains" (e.g. Austria, Belgium, Bulgaria, the Czech Republic, Estonia, Slovakia, Slovenia, Switzerland), but there are also countries that classify them under "business profits".

In addition, there is no consensus with respect to the classification of premium payments paid to acquire call stock options. The classification could be "other income", "business profits", or "capital gain". In some countries this classification is even considered to be irrelevant (due to the absence of taxation in the source country in any case; the qualification being then more relevant for the country of residence of the beneficiary).

In Germany permanent payments (if any) should qualify as "other income". Where a sale of the swap agreement or futures is concerned, a differentiation should be made between two situations. If the underlying value is physically delivered the payment qualifies as "capital gain". On the other hand, cash settlements qualify as "other income".

3.2.7. *Difference if Counterparty is a Non-Financial Institution*

262. **No Difference.** In most countries, there is no difference in tax treatment if one or both counterparties are companies in the non-Financial Sector as opposed to the Financial Sector. If there is a difference, it is usually linked to a difference in accounting treatment. Some examples are listed below.

In Bulgaria, there is a difference in tax treatment between financial and non-financial institutions. Financial institutions recognise gains or losses on financial instruments (e.g. equity swaps, financial futures and call stock options) when they occur, whereas non-financial institutions recognise the gains or losses only on disposal upon the instrument's maturity.

In the USA, there could possibly be differences. For example, there may be a difference if a futures contract is used as a hedging transaction as opposed to a speculative transaction. As far as call options are concerned, dealers in securities, as opposed to non-dealers, typically have to apply mark-to-market accounting to options, potentially accelerating basis recovery.

Financial institutions in France usually apply a tax treatment that differs from that for non-financial companies, applying a mark-to-market approach, which results in taxation or deduction of unrealised gains or losses at each financial year closing date.

In Germany, as far as equity swaps and financial futures are concerned, taxes are deducted by the counterparty (generally a credit institution) paying any profit under the swap or future agreement to the recipient. Corporations can credit the deducted tax against their corporate income tax liability. However, if the recipient is a credit or financial institution, taxes are not deducted from the income. Instead, such institutions declare the taxable income in their corporate tax returns.

Contrary to normal companies, Greek banks are obliged to submit a tax return to pay tax on the balance of a special reserve in relation to capital gains deriving from listed derivatives. Following payment of this tax, the remaining profits should be booked in a special account and can be distributed or capitalised free of tax.

In Ireland and the UK, there is a difference in tax treatment depending on the trading nature of the transaction. In the case of transactions other than trading transactions, these countries' capital gains rules might apply as opposed to the Irish general tax rules or the UK's derivative contract rules. For example, if a non-financial player is involved and the underlying subject-matter relates to equities, then it is possible that the UK derivative contract rules will be inapplicable, in which case the general capital gains rules apply. In Ireland non-financial players are disadvantaged by comparison with financial players: if the tax category is Irish capital gains tax, to which the non-Financial Sector is most likely to be liable, gains are taxed at 25% while, if the derivative relates to a trading transaction, which is normally the case for the Financial Sector, trading treatment should apply at 12.5%.

In Sweden, if both parties are companies in the Financial Sector, the general tax regime, based on accounting treatment, will apply. However, for a party that is not a financial company, the capital gains rules apply, which typically deviate from the accounting treatment in terms of timing (i.e. recognition of gains and losses). In addition, there are some differences in treatment with respect to call stock options: a financial company (holder) may deduct an anticipated (unrealised) loss on expiration of the call stock option and deduct it from any kind of income, whereas a non-financial company may only deduct realised losses, and only from capital gains on stocks and other equity-based securities. Also, for the financial company that wrote the option, the premium received is taxable when it is recognised in the profit and loss account while, for non-financial companies, the premium received is taxable either when the option expires (for "marketable" options with a term not exceeding 12 months) or immediately (for other options).

In Slovakia, the overall loss from transactions with derivatives is generally not tax-deductible. However, this is not the case if the taxpayer is a company in the Financial Sector.

3.2.8. *Differentiation amongst Domestic Company, Subsidiary or Branch*

263. **No Difference.** Apart for Singapore and the USA, which are third countries, there is in principle no difference in tax treatment with respect to the above topics according to whether the (financial) institution is a domestic one or a subsidiary or a branch (considered as a permanent establishment for double tax treaty purposes, to which the operations under review could be attributed) of a non-domestic (financial) institution.

In Singapore, WHT may be deducted at source by other Singaporean-based payers for certain payments made to a branch (differentiation based on the tax residence of the beneficiary), unless it has obtained an appropriate administrative waiver from the tax authorities.

In the USA, there could be potential differences depending on whether the institution in question is a company or a branch. For example, in the USA, branches of foreign financial institutions are subject to complex rules regarding income inclusion and the availability of certain deductions.

3.2.9. *Practices*

264. **In line with Legal Provisions.** In most countries, there is generally no information as to whether actual practice differs from the relevant legal provisions.

265. **Inconsistencies.** Nevertheless, this does not mean that actual practice is always consistent in a given country (or between sectors). The different types of issues reported are closely linked to the level of sophistication of the relevant tax legislation (which is, in turn, linked to the existing local market with respect to the relevant financial instruments):

- It has been reported that, in some countries, the local market is not at present fully developed, so that there is no real actual practice to speak of (e.g. Slovenia);
- Other countries reported that tax rules regarding derivatives are not very detailed, nor is the official guidance from the tax authorities, so that it is necessary to refer to the general provisions and principles of tax law, which leads to uncertain/inconsistent practices (e.g. Cyprus, Latvia, Malta, Romania);
- In other cases, the law provides flexibility so that there could be more than one way to appropriately reflect a transaction in financial statements and, hence, for tax purposes (e.g. Switzerland);
- Other countries reported the need to refer to a pragmatic approach in complex situations (e.g. the UK) or to a substance-over-form principle (e.g. the USA);

- Other countries reported potential inconsistency between sectors of activity due to the lack of official guidelines or limited case law (e.g. France and Poland);
- Finally, the state of constant flux in the tax provisions applying to derivatives has also been reported (China).

It is therefore usually recommended that transactions should be analysed on a case-by-case basis.

4. CONCLUSION

266. **Two Parts.** This Chapter can be split into two parts: indirect taxation on the one hand (securities transaction tax), direct taxation on the other hand (selected derivatives).

267. **Securities Transaction Tax.** As far as the first part is concerned, it can be concluded that not all countries in scope apply securities transaction taxes, and those that do have this type of tax all apply different rules and rates. In other words, there is no uniformity with respect to the scope of the taxes, tax rates or taxable bases. In some countries, the securities in scope are more limited than in others, where, in addition to equities, derivatives and loan instruments are also targeted. Another crucial distinction that can be made is the public or private character of the transactions in scope.

268. **Selected Derivatives.** The second part of this Chapter addresses a more complex and technical matter, namely the tax treatment of equity swaps, financial futures and call options on stock. As explained above, few countries have developed any specific tax rules dealing with this kind of instrument and those that have not apply the general tax rules.

269. **Role of Accounting Treatment.** Since tax law is based on accounting law in the majority of the countries, it goes without saying that accounting treatment has a decisive impact on tax treatment. Differences in accounting treatment will indirectly result in differences in tax treatment.

These differences can be explained by the application of local GAAP versus IFRS, different valuation methods, such as mark-to-market versus the LoCoM or historical method, accrual accounting versus cash accounting, prudence principle versus matching principle, etc. The hedging or trading purpose of a financial instrument will in most cases also trigger a different accounting treatment. However, the differences that originate from a different accounting treatment in most cases come down to timing differences.

270. **Different Tax Systems.** The other main reason underlying differences in tax treatment between countries is the fact that some have a general corporate income tax regime that is

"original" compared to other countries. Some countries also provide for capital gains taxation for which separate rules apply. However, this does not necessarily mean that financial institutions in these countries are treated differently from "normal" companies.

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GENERAL CONCLUSION

271. **Corporate Taxation.**

We found no evidence that banks have a significantly lower or higher corporate income tax burden than companies active in other sectors, to the exclusion of bank levies. As a general rule, the applicable standard corporate tax rate (including any municipal rates), computation of the tax base, deductible items or tax reliefs and so forth are generally the same for banks as for companies active in other sectors. There may be some differences specific to the bank business, but *prima facie* these differences do not appear significant.

272. **Value-Added Taxation.**

Some key third countries like Switzerland and Singapore have VAT exemptions in place similar as those foreseen in the VAT Directive 2006/112/EC which do not allow a VAT deduction. Other key third countries, like China, have other systems in place such as for example a Business tax or have no special tax on financial transactions excluding insurance premium tax which is for example the case in the US.

Only seven EU member States have implemented the "option to tax" system in the EU community allowing a VAT deduction of input VAT on financial services. However there is a wide divergence in scope and application between these Member States. A similar system as the "option to tax regime" of the Directive cannot be retrieved in the key third party countries covered by this Study.

A lot of EU Member States have or will introduce other taxes on financial transactions. Only a few of these taxes have clearly been introduced to compensate for the application of VAT exemptions in Member States, while for the other countries such a direct link with the existence of the VAT exemptions on financial transactions does not exist. The most common additional tax on financial services is the insurance premium tax but there is again a wide divergence in scope and application between the EU Member States.

273. **Labour Taxation.**

We found no evidence that, prior to the financial crisis, lawmakers in the 31 surveyed countries adopted any specific tax concessions or surcharges exclusively applicable to pay in the Financial Sector. While 7 surveyed countries reported having taken legal initiatives to apply tax surcharges to pay in the Financial Sector after the financial crisis, only 3, being Greece, Italy and Ireland, still apply these surcharges today.

In addition, assuming that the Financial Sector has more intensively resorted to equity incentives in its pay packages, we found no evidence that this practice would have led to an actual alleviation of tax burdening pay in the Financial Sector. Indeed when tax concessions were applicable to equity incentives they were almost always conditional.

In conclusion, we found no evidence that pay in the Financial Sector would have benefitted from any specific explicit or implicit alleviation of tax in comparison with other sectors.

274. **Financial Instruments.**

It results from the Study that not all survey countries apply securities transaction taxes, and that there is no uniformity with respect to the scope of these taxes.

With respect to the tax treatment of equity swaps, financial futures and call options on stock, few countries have developed any specific tax rules dealing with this kind of instrument. In any case, since tax law is based on accounting law in the majority of the countries, the accounting treatment has often a decisive impact on tax treatment. Differences in accounting treatment will indirectly result in differences in tax treatment. Other than that, we have not found major differences in the tax treatment applicable to these instruments between Financial and Non-Financial Institutions.

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ENCLOSURE 1: GENERAL TAX REGIME APPLYING TO BANKS

Country (April 2011)	Corporate Income Tax Rate	Local Taxes	Special Levy	Remarks
AUSTRIA	25% (Annual min. CIT): ▪ EUR 5,452 for banking institutions; ▪ EUR 1,750 for private limited liability companies (non-financial institutions); ▪ EUR 3,500 for public limited liability companies (non-financial institutions).	No	1) Levy to finance the chamber of commerce 2) From 1/1/2011, Bank levy: 2 taxable bases: - Capital assets (based on the unconsolidated balance sheet total). Tax on capital assets calculated on a modified average unconsolidated balance sheet total – tax rate of 0.055%-0.085% depending on certain threshold – allowance if tax base < €1 billion; - Derivatives in the trading book: tax rate of 0.013% based on their nominal value – no allowance for derivatives.	
BELGIUM	33.99%	No	No	
BULGARIA	10%	No	No	
CYPRUS	10%	No	Proposed bank levy: legislation is being considered by parliament, to tax deposits excluding inter-bank deposits at a rate of 0.095% (total levy not to exceed 20% of taxable profits).	
CZECH REPUBLIC	19%	No	No	

Country (April 2011)	Corporate Income Tax Rate	Local Taxes	Special Levy	Remarks
DENMARK	25%	No	No	Payroll tax (applicable to all entities not subject to VAT), in effect applicable mainly to financial entities, including banks: 10.5% of the payroll total.
ESTONIA	21%	No	No	CIT only upon distribution of profits.
FINLAND	26%	No	No	
FRANCE	33.33% but a 3.3% 'social tax contribution' may also apply (if CIT exceeds K€ 763), i.e. effective tax rate may be 34.43%	No	Bank levy: financial bill for 2011 created a new 'tax on systemic risks' specific to banks, which will be paid in addition to contributions paid by the financial institutions to the deposit guarantee fund and supervision fees. In a nutshell, a 0.25% tax is assessed on the amount of the bank's equity over EUR 500 million. PEs of foreign banks resident in an EEA country are not subject to this levy.	

Country (April 2011)	Corporate Income Tax Rate	Local Taxes	Special Levy	Remarks
GERMANY	15% + 5.5% solidarity surcharge	Yes ('trade tax'), of between 7 and 17.1% depending on the relevant municipal rate (14.35% in Berlin)	- A bank levy (annual levy) is applicable from 1 January 2011 and falls due annually on 30 September. The base for calculating the levy is the sum of: 1) a progressive rate of 0.02 - 0.04% calculated on balance sheet total less liabilities to customers (without liabilities towards affiliate entities) less certain other items (such as funds for general bank risks) and liable equity capital; and 2) 0.00015% of nominal amount of derivatives. The bank levy is limited to a maximum of 15% of net profits plus certain other items and a minimum of 5% of the regular annual contribution. - Discussions have taken place regarding a financial transaction tax. However, there are currently no specific legislative proposals.	
GREECE	20% for accounting year 2011	No	Bank debt is subject to a special levy of 0.6% annually on the loan value (L. 128/75).	

Country (April 2011)	Corporate Income Tax Rate	Local Taxes	Special Levy	Remarks
HUNGARY	10% up to HUF 500 million tax base, 19% above	Yes (in Budapest: 2%). It is noted that the local business tax base is determined differently from the tax base of the corporate income tax.	Bank levy with start date on 27 September 2010: Progressive rate of 0.15% up to HUF 50 billion and 0.53% on the excess. The levy is calculated on the adjusted balance sheet total (i.e. less, inter-bank lending and loan receivables, etc.). The bank levy is also applicable to other financial institutions (i.e. insurance companies, broker-dealers, etc.), for which different rates may apply.	
IRELAND	12.5% on trading income; 25% on passive income	No	No	
ITALY	27.5%	Regional income tax (introduced in 1997): ▪ 3.9% for non-FS ▪ 4.82% for FS ▪ may vary according to region.	No	
LATVIA	15%	No	Yes, financial stability duty of 0.036% per annum, in force from 1 January 2011, payable by Latvian banks, foreign branches of Latvian banks and Latvian branches of foreign branches	
LITHUANIA	15%	No	No	

Country (April 2011)	Corporate Income Tax Rate	Local Taxes	Special Levy	Remarks
LUXEMBOURG	21% + 5% solidarity surcharge = 22.05% from 1/1/2011	Yes, 'municipal business tax': varies between 6.75% and approx. 9%. Banks established in Luxembourg city: total combined CIT/MBT rate = 28.8%	Net wealth tax (computed on net asset value), applicable to all corporations at a rate of 0.5%. No (proposed) bank levies or financial transactions tax.	
MALTA	35%	No	No	
NETHERLANDS	25% (with step-up of 20% on first EUR 200,000 of taxable income)	No	No	
POLAND	19%	No	No bank levy or financial activities tax. Currently, a bill to introduce a levy on banks and certain other financial institutions has been proposed by the opposition party in parliament. Given the make-up of parliament, even if the law is ultimately passed, it is unlikely that it will take the form presented in the bill.	
PORTUGAL	25%	1.5% maximum local surtax; Reduced rate for Madeira Region but not applicable to banks or FS.	In 2011 the banking sector will be subject to a new contribution regime in addition to the standard tax rates. *Taxable base & tax rates* Base I : Total liabilities less, amongst others: ▪ Items that are accounted for as equity; ▪ Liabilities for defined benefit retirement plans; ▪ Provisions;	

Country (April 2011)	Corporate Income Tax Rate	Local Taxes	Special Levy	Remarks
			▪ Liabilities concerning revaluation of financial derivatives; ▪ Receipts related to deferred income, irrespective liabilities' operations; and ▪ Liabilities related with assets which were not accounted for in securitization's operations. Part of the bank deposit actually covered by the Deposits Guarantee Fund Tax rate foreseen: 0.05% Base II: The notional amount of off-balance sheet financial derivatives, excluding hedging derivatives and back to back derivatives. Tax rate foreseen: 0.00015%	
ROMANIA	16%	No	Proposal of 'solidarity tax' on profits derived by the financial services sector, temporary tax, proposed rate: 2.5% on profits derived during previous fiscal year. As the proposal is still pending in parliament, it will probably not come into effect in the near future.	
SLOVAKIA	19%	No	- No - The Slovak Ministry of Finance has presented its proposal to introduce taxation of banks in 2012. It is not yet clear whether it will be a tax levied on the liabilities of the financial institution or a financial activities-based tax.	
SLOVENIA	20%	No	No	

Country (April 2011)	Corporate Income Tax Rate	Local Taxes	Special Levy	Remarks
SPAIN	30%	No surcharges or local direct taxes, but from a CIT/direct taxation perspective, rules differ depending on the territory (for instance special rules applicable to the Vasc region).	No	
SWEDEN	26.3%	No	Bank levy effective as from 30 December 2009, for financial years ending after that date: 0.036% of total amount of debt and provisions less intra-group liabilities and other items. This tax rate is halved for financial years 2009 and 2010.	
UK	Currently 28% but will drop by 1% each year from 1/4/2011 to reach 24%	No	Bank levy applicable as from 1 January 2011: 0.075% although lower rate of 0.04% for 2011 and 0.0375% for long-term liabilities. The bank levy is applicable to global consolidated balance Sheet liabilities less 'Tier 1', insurance liabilities, protected deposits, sovereign repo liabilities and other items (derivatives on a net basis). For calculation of the taxable base, a threshold of £20 billion is applied.	
CHINA	25%	No	No	
SINGAPORE	17%	No	No	Notwithstanding the standard corporate tax rate, concessions are available for specific types of income (see comments under 'Specific tax regime applicable to banks').

Country (April 2011)	Corporate Income Tax Rate	Local Taxes	Special Levy	Remarks
SWITZERLAND	For FY 2010, the applicable standard CIT rate (including cantonal/ communal and direct federal taxes) varies between 12.66% and 24.23%, depending on the canton where the company is located.	Surcharges and additional local taxes may be levied mainly in the French-speaking cantons (e.g. 'taxe professionnelle communale' in the Canton of Geneva)	No	
USA	Maximum 35% federal rate	State and local rates vary (can vary widely across jurisdictions).	Currently no bank levy in the USA; Proposals made in 2010 did not garner sufficient Congressional support; A recent 2011 proposal by the Obama administration is, at this point, also unlikely to receive sufficient Congressional support to be enacted, especially in the House of Representatives.	

ENCLOSURE 2: THIN CAPITALIZATION RULES

Country	1. Do you have thin cap rules in your country?	2. Are these thin cap rules applicable to related-party interest?	3. Are these thin cap rules applicable to third-party interest?	4. Do thin cap rules apply to banks?	5. If your answer to question 4. is yes, please specify, if applicable, the differences between the thin cap rules for banks and the thin cap rules for companies of other sectors/non-banks.
AUSTRIA	Yes	Yes	No	Yes	A specific minimum equity is required for banks (according to Basel II). Generally, for branches of foreign banks endowment capital has to be attributed for taxation purposes only (e.g. based on the equity requirements imposed by the Austrian Banking Act) according to the OECD report on the attribution of profits to permanent establishments dated July 17, 2008.
BELGIUM	No general thin cap rules. A debt-equity ratio may apply in the following cases: - 7:1 if interest is paid to taxpayers benefiting from a tax regime more advantageous than the Belgian one on the income received and provided certain limits are exceeded - 1:1 if interest is paid to a director or a person exercising similar functions and to the extent certain limits are exceeded	No	No	No	N/A
BULGARIA	Yes	Yes	Yes	No	N/A

Country	1. Do you have thin cap rules in your country?	2. Are these thin cap rules applicable to related-party interest?	3. Are these thin cap rules applicable to third-party interest?	4. Do thin cap rules apply to banks?	5. If your answer to question 4. is yes, please specify, if applicable, the differences between the thin cap rules for banks and the thin cap rules for companies of other sectors/non-banks.
CYPRUS	No	N/A	N/A	No	N/A
CZECH REPUBLIC	Yes	Yes	No	Yes	The debt to equity ratio for banks and insurance companies is 6:1, whereas for other companies the ratio is set at 4:1.
DENMARK	Yes	Yes	The calculation of the 4:1 debt to equity ratio is made based on all debt in the company. However, only related debt would be subject to limitations.	No	N/A
ESTONIA	No	N/A	N/A	No	N/A
FINLAND	No	N/A	N/A	No	N/A
FRANCE	Yes	Yes	No	No	N/A
GERMANY	Yes	Yes	Yes	Yes	The German thin cap rules are also applicable to banks. However, according to the mechanism of the German interest capping rules (interest expenses are always tax deductible to the extent they do not exceed interest income earned) banks are typically not burdened by the German thin cap rules.

Country	1. Do you have thin cap rules in your country?	2. Are these thin cap rules applicable to related-party interest?	3. Are these thin cap rules applicable to third-party interest?	4. Do thin cap rules apply to banks?	5. If your answer to question 4. is yes, please specify, if applicable, the differences between the thin cap rules for banks and the thin cap rules for companies of other sectors/non-banks.
GREECE	Yes: interest corresponding to loans exceeding the 3:1 debt to equity ratio is not tax deductible	Yes	No. However, loans granted by 3rd parties and guaranteed by a related party are taken into account for the calculation of the 3:1 ratio.	No	N/A
HUNGARY	Yes	Yes (except related party in the bank sector)	Yes (except third-party in the bank sector)	Yes	For the computation of the debt-to-equity ratio (=3:1), banks do not have to take into consideration their liabilities in connection with their financial services activities, whereas other companies do.
IRELAND	No (However, certain requalification may apply when interest payments are made to a 75% non-resident group member).	N/A	N/A	No	N/A
ITALY	No	N/A	N/A	No	Interesting to mention is that interest expenses incurred by banks are deductible at 96%, whereas for companies of other sectors/non-banks, interest expenses are fully deductible provide that they do not exceed specific ratios.

Country	1. Do you have thin cap rules in your country?	2. Are these thin cap rules applicable to related-party interest?	3. Are these thin cap rules applicable to third-party interest?	4. Do thin cap rules apply to banks?	5. If your answer to question 4. is yes, please specify, if applicable, the differences between the thin cap rules for banks and the thin cap rules for companies of other sectors/non-banks.
LATVIA	Yes	Yes	Yes, except for interest on loans from credit institutions (banks) resident in EU, EEA and double tax treaty countries and some other specified institutions (e.g. EBRD, WB, etc.)	No	N/A
LITHUANIA	Yes	Yes	Yes, provided that third party loan is guaranteed by related party.	Yes	The thin cap rules do not apply to financial institutions providing financial leasing services. There are no exceptions/differences for banks and companies of other sectors/non-banks.
LUXEMBOURG	Yes	Yes	In principle NO. But it could be applicable in specific cases.	Yes	No differences between banks and non-banks
MALTA	No	N/A	N/A	No	N/A

Country	1. Do you have thin cap rules in your country?	2. Are these thin cap rules applicable to related-party interest?	3. Are these thin cap rules applicable to third-party interest?	4. Do thin cap rules apply to banks?	5. If your answer to question 4. is yes, please specify, if applicable, the differences between the thin cap rules for banks and the thin cap rules for companies of other sectors/non-banks.
NETHERLANDS	Yes	Yes, the amount of non-deductible interest should only be limited to the extent that intercompany interest paid exceeds intercompany interest received.	Yes	Yes	No differences between banks and non-banks
POLAND	Yes	Yes	No	Yes	No differences between banks and non-banks
PORTUGAL	Yes, a 2:1 debt to equity ratio applies. A safeguard clause is available, in case the taxpayer is able to demonstrate that the level of debt and other conditions are at arm's length.	Yes, on interest from a related party that is resident outside the EU	Yes, if guaranteed by a related party	Yes	No differences
ROMANIA	Yes (also safe harbour rule according to which the deductibility of interest expenses on loans provided by entities other than banks/financial institutions is capped at a specific interest rate, which depend on the currency of the loans).	Yes	Yes	No	N/A
SLOVAKIA	No	N/A	N/A	No	N/A

Country	1. Do you have thin cap rules in your country?	2. Are these thin cap rules applicable to related-party interest?	3. Are these thin cap rules applicable to third-party interest?	4. Do thin cap rules apply to banks?	5. If your answer to question 4. is yes, please specify, if applicable, the differences between the thin cap rules for banks and the thin cap rules for companies of other sectors/non-banks.
SLOVENIA	Yes	Yes	No, unless the loan is guaranteed by a related party.	No [the tax haven rules apply to all entities and are not thin cap rules]	For non-bank entities, the thin cap rules restrict the tax deductibility of interest on loans from direct or indirect parents or subsidiaries (where the shareholding relationship is at least 25%), to the extent that the loan amounts exceed 4 times equity (from 2012 onwards, and 5:1 for 2011). This restriction does not apply to banks.
SPAIN	Yes. According to article 20 Corporate Tax Act, when the net remunerated direct or indirect borrowing of an entity from other related persons or entities which are not resident in Spanish territory, **excluding financial institutions**, exceeds the result of applying the coefficient of 3 to the fiscal capital, the accrued interest which corresponds to the excess will be regarded as dividends. Thin capitalization rule does not apply when the non-resident entity is located in a EU country (except tax havens jurisdictions).	Yes, this rule applies exclusively to related persons or entities (direct or indirectly).	No	No (except for interest related to payments to tax havens).	N/A

Country	1. Do you have thin cap rules in your country?	2. Are these thin cap rules applicable to related-party interest?	3. Are these thin cap rules applicable to third-party interest?	4. Do thin cap rules apply to banks?	5. If your answer to question 4. is yes, please specify, if applicable, the differences between the thin cap rules for banks and the thin cap rules for companies of other sectors/non-banks.
SWEDEN	No	N/A	N/A	N/A	N/A
UK	Yes	Yes	Yes	Yes	Banks cannot apply 'safe-harbours' and thin cap rules are based on the regulatory capital position. The 'debt cap' restrictions which limit interest deductions available in the UK by reference to the group's external borrowing do not apply to banks.
CHINA	Yes	Yes	No	Yes	The debt-to-equity ratio for banks (and for all the financial industry) is 5:1, whereas for the non-Financial Sector the ratio is set at 2:1.
SINGAPORE	No	N/A	N/A	No	N/A
SWITZERLAND	Yes	Yes	No	Yes (but not the same rules as for non-financial service, see next column)	For Swiss regulated banks, the minimal equity required for tax purposes is equal to the minimal equity required for Swiss regulatory purposes.
USA	Yes	**Please complete**	**Please complete**	Yes	**Please complete**

ENCLOSURE 3: INTEREST WHT RATE

Country	Interest WHT rate
AUSTRIA	25%
BELGIUM	15%
BULGARIA	10%
CYPRUS	0%
CZECH REPUBLIC	15%
DENMARK	25%
ESTONIA	21% on excessive part of interest
FINLAND	28%
FRANCE	0% (50% for NCST payments)
GERMANY	25%+5.5% solidarity surcharge
GREECE	40%
HUNGARY	0%
IRELAND	20%
ITALY	12.5%
LATVIA	5 or 10%
LITHUANIA	10%
LUXEMBOURG	0%

Country	Interest WHT rate
MALTA	15%
NETHERLANDS	0%
POLAND	20%
PORTUGAL	21.5%
ROMANIA	16%
SLOVAKIA	19%
SLOVENIA	15%
SPAIN	19%
SWEDEN	0%
UK	20%
CHINA	10%
SINGAPORE	17%
SWITZERLAND	35%
USA	30%

ENCLOSURE 4: DIVIDEND WHT RATE

Country	Dividend WHT rate
AUSTRIA	25%
BELGIUM	25% (15% on certain dividends)
BULGARIA	5%
CYPRUS	0%
CZECH REPUBLIC	15%
DENMARK	28%
ESTONIA	No
FINLAND	28%
FRANCE	25% (50% for NCST[7] payments)
GERMANY	25% + 5.5% solidarity surcharges
GREECE	25% (for profit distributions during 2011, the applicable WHT rate is 21%)
HUNGARY	0%
IRELAND	20%
ITALY	From 0 to 27%
LATVIA	10%
LITHUANIA	15%
LUXEMBOURG	15%
MALTA	No (subject to the satisfaction of certain statutory conditions)
NETHERLANDS	15%
POLAND	19%
PORTUGAL	21.5%
ROMANIA	16%
SLOVAKIA	0%
SLOVENIA	15%
SPAIN	19%
SWEDEN	No
UK	No
CHINA	10%
SINGAPORE	0%
SWITZERLAND	35%
USA	30%

[7] NCST: Non Cooperative States and Territories.

ENCLOSURE 5: INTEREST AND DIVIDEND PAYMENTS TO BANKS (AS BENEFICIARIES) – IS THERE A WHT EXEMPTION OR A REDUCED RATE FOR BANKS?

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
AUSTRIA	No In general, only banks (domestic institutions, subsidiaries or branches licensed for banking business) are obliged to deduct WHT on interest in Austria. 1. Interest paid to a foreign Bank According to Austrian tax law, interest income received by non-residents in Austria is generally not subject to WHT taxation, if a proof of foreign residence is provided to the Austrian paying agent. Hence, interest paid to a foreign Bank is generally not subject to WHT in Austria. 2. Interest paid to an Austrian Bank In general, interest paid by an Austrian Bank to another Austrian Bank is exempt from WHT in Austria due to a specific exemption in the Austrian Income Tax Act.	Yes Generally, dividends paid by an Austrian resident to a Bank (resident in Austria or abroad) are subject to WHT in Austria. Austrian recipients (Austrian Banks and subsidiaries) may claim the Austrian WHT in the corporate income tax return. An exemption from WHT is generally granted for the distribution of dividends by an Austrian corporation to an Austrian or EU parent company if the parent holds a participation of at least 10 % over a period of more than 1 year. This exemption is applicable for all companies regardless of whether they are banks or not. Furthermore, some double tax agreements concluded by Austria provide for dividends (distributed by Austrian companies) to be exempt from WHT or to be subject to a reduced WHT rate. Requirement for the respective exemption/reduction is a proof of foreign residence.	A specific WHT exemption for the banking sector is that interest paid by one Bank to another Bank is explicitly exempt from WHT in Austria. This exemption is also applicable if the recipient is a foreign Bank (which is generally not subject to WHT taxation anyway).

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
BELGIUM	The general Belgian WHT on interest payments amounts to 15%. The Belgian internal tax law as well as DTT concluded by Belgium provide for several reductions and/or exemptions in this respect. Please note that such reductions/exemptions generally depend on certain conditions such as amongst others the capacity of the debtor, the capacity of the receiver and the underlying interest generating financial instrument. The Belgian domestic law provides for specific exemptions in case the debtor and/or the receiver is a bank. For instance a WHT exemption is available in case of interest paid: - on loans by a Belgian credit institution to credit institutions established abroad; - on loans by professional investors (basically all Belgian corporate investors) to credit institutions established in, inter alia, the European Economic Area or in a country which has concluded a DTT. Other WHT exemptions on interest payments are available for Belgian standard companies	A Belgian WHT of 15% or 25% is due for dividends distributed by Belgian resident companies to foreign companies (including banks) or to a Belgian branch of a foreign entity, unless the conditions under the EU Parent-Subsidiary Directive are complied with. Other WHT reductions/exemptions can also be applicable according to domestic law or double tax treaties. Finally, as regards to WHT on dividend distributions, no immediate exemptions proper to banks come to mind as opposed to other companies.	We refer to our comments in column 1 (specific WHT exemption for interest payments, although other WHT exemptions are available under certain conditions for standard resident companies).
BULGARIA	There is 10% WHT on interest payment to non-resident banks. The WHT may be reduced to 5% under the rules of the Interest-Royalty Directive. No WHT applies on interest payment to corporate residents (including banks)	There is 5% WHT on dividend payment to non-resident banks. The WHT may be reduced to 0% under the rules of the Parent Subsidiary Directive. No WHT applies on dividend payment to corporate residents (including banks).	No

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
CYPRUS	No	No	No
CZECH REPUBLIC	No	No	No
DENMARK	In principle, only WHT on intra-group debt from a Danish debtor to a creditor resident abroad.	Yes, 28% WHT (27% from 2012) on dividend payments on portfolio shares (less than 10% ownership) to a foreign bank. No Danish WHT on dividends on shareholdings of more than 10%, provided the recipient is the beneficial owner of the dividends and resident in an EU state or a state with which Denmark has a DTT.	No
ESTONIA	No, arm's length interest is not subject to WHT. Excessive interest exceeding the arm's length value may be subject to 21% WHT, if paid to non-residents.	No	No

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
FINLAND	No WHT is levied on interest payments to Finnish resident companies (including banks). Finland does not levy WHT on interests paid to non-residents unless the tax authorities would deem that the true nature of the loan is equity capital.	No WTH is levied on dividends paid by Finnish resident limited companies to Finnish resident companies (including banks) Dividends paid by a Finnish resident to a non-resident bank are subject to a WHT of 28%, unless a tax treaty provides for a lower rate or an exemption. However, dividend payments to EU resident companies covered by the EU Parent - Subsidiary Directive and holding at least 10% in the distributing company are exempt from WHT. Further, no WHT is levied on dividend payments received by companies resident in the EU/EEA area (other than in Liechtenstein), which would have been tax-free if paid to a Finnish corporate body, if the WHTes cannot be credited in the company's state of residence.	The depicted rules are not bank sector specific but are generally applicable. There are no WHT exemptions or reduced rates for banks.
FRANCE	Interest paid to a bank should not be subject to WHT provided they are not paid on a bank account located in an Non Cooperative State or Territory ("NCST").	A 25% WHT could be levied on dividend paid to a bank. This rate can: - be reduced in accordance with the provisions of a DTT; or - be increased to 50% should the payment be made on a bank account located in an NCST. No WHT would be levied for payments made to a company located in an E.U. country (provided the payment is effectively made on a bank account located in the E.U.)	The nature of the activity of the company receiving the payment of the interest/dividend has no impact over the application of a potential WHT.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
GERMANY	Generally, interest on plain vanilla loans paid to a bank by a German resident are not subject to German WHT. A WHT of 26.375% would only be applicable if the interest payments were paid by a German bank to a foreign bank and the interest or the underlying loan facility were collateralized with German real estate or German ships.	Dividend paid to a resident or non resident bank by a German resident are subject to WHT of 26.375%. However, if the receiving bank is a foreign corporate entity, it would be entitled to a partial refund of the withheld tax effectively reducing the tax rate to 15.825%. Furthermore, the foreign bank may be entitled to a full or partial exemption or refund of the WHT under double tax agreements. Finally, dividend payments to a EU-resident bank qualify for a full refund of the WHT under the EC-Parent-Subsidiary-Directive.	It should be noted that a specific exemption from the obligation to withhold tax on interest payments (so called "bank privilege") is applicable in cases of German domestic interbank loans.
GREECE	Interest paid to a Greek Bank by Greek residents is not subject to WHT. Interest paid to a foreign Bank by Greek residents is subject to a 40% WHT, which can be reduced by application of the Interest-Royalty Directive or an applicable DTT.	Yes. Dividends paid by Greek companies are subject to a 25% WHT (21% for 2011), irrespective of the recipient (Greek or foreign, legal entity or individual). The only available exemption applies to dividends paid to an EU parent company provided the conditions of the Parent –Subsidiary Directive are met.	Interest paid by Greek residents to ordinary Greek companies is subject to a 20% WHT (as securities income). The exemption from WHT to interest paid to Greek Banks is based on the characterization of the interest as ordinary business income for the Banks. There is no differentiation to interest paid to foreign Banks or ordinary companies.
HUNGARY	No	No	No specific rule.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
IRELAND	In the case of interest, no WHT in the case of payments to an Irish resident bank. WHT applies in the case of interest payments to a non-resident (including a bank) except where the interest is paid by a bank in the course of its business. There are a number of other exceptions to this requirement and these are set out in Section 246 Tax Consolidation Act 1997. WHT applies where interest is paid to companies in the State other than banks.	No WHT where dividend paid by an Irish company to another Irish company. The dividend income is not taxable in the hands of the recipient company. In the case of payment to an individual, WHT is deducted and the individual is taxable on the dividend which is subject to a credit for WHT. In the case of a dividend paid by an Irish company to a foreign company, the foreign company can claim to have the dividend paid without WHT.	If interest is paid by a bank in the course of its business, no WHT applies.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
ITALY	- No WHT on interest paid to Italian banks; - No WHT on interest paid to foreign banks by Italian banks; - Generally speaking, interest on loans and advances paid to foreign entities (including foreign banks) are subject to a 12,5% WHT (27% if the foreign entity is located in a black list country). Broadly speaking, also interest collected by resident standard companies (other than banks) referring to loans are not subject to WHT. Instead, interest collected by "standard companies" with reference to bank deposits and bank accounts are subject to WHT at 27%. Finally, interest relating to bonds is subject to the same tax treatment both for banks and other companies: generally no WHT applies. Nevertheless there are some exceptions to this general rule.	Dividends paid by an Italian company (including banks) to other Italian banks or foreign banks are subject to the following tax regimes: - no WHT If paid to Italian banks; - no WHT if paid to banks resident in EU Member States under the provisions of EU Parent-Subsidiary Directive (as implemented by the Italian tax law); - 1.375% WHT if paid to other European banks subject to the CIT in one of the EU Member State or in an EFTA State; - 27% WHT if paid to non-residents banks other than those listed above. This rate decreased to 12.5% if the dividends are related to saving shares. Moreover the WHT rates can be reduced according to the provisions of double tax treaty when applicable. “Saving shares” are shares without voting rights. Compared with “ordinary shares” (having voting rights), saving shares grant to the owner some additional economic benefits. Also, no WHT applies on dividends paid to resident standard companies.	Domestic tax law provides the exemption of WHT on interest paid from Italian banks and Italian PE of foreign banks to foreign banks and foreign PE of Italian banks. As far as dividend, the same tax treatment applies both to banks and other companies.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
LATVIA	Only interest paid to related non-resident party is subject to WHT. Tax rate is 5% on interest to related EU/ EEA company (as defined by the law) and 10% on interest to any other related non-resident party. If the debtor is a Latvian bank, then it must deduct 5% WHT from interest paid to a non-resident related party (both EU/ EEA and non-EU/EEA).	Generally, dividends are subject to 10% WHT. Dividends paid to EU companies (i.e. companies that have certain legal form, pay corporation or similar tax and are tax residents in relevant EU/ EEA country) are not subject to WHT provided certain administrative requirements are fulfilled. WHT rate under most double tax treaties is reduced to 5%. All these rules are applicable both to the bank sector and to other sectors.	It is specific to the bank sector that banks are entitled to deduct 5% WHT from interest paid to a non-resident related party (both EU/EEA and non-EU/EEA). Debtors in other sectors must deduct 10% WHT from interest to related non-resident parties and may apply 5% WHT rate only on interest paid to related EU/ EEA companies (as defined by the law).
LITHUANIA	As from 1 January 2010 interest paid to foreign entity (no matter if it is a bank or other company) established in the European Economic Area or in countries with which Lithuania has a DTT signed is not subject to WHT in Lithuania (in other cases WHT of 10% is applied). Interest paid to Lithuanian entity (no matter if it is a bank or other company) is not subject to WHT.	Dividends paid to foreign or Lithuanian entities (no matter if it is a bank or other company) are not subject to WHT, provided that participation exemption rule is satisfied (not less than 10% of voting shares are held for not less than 12 months). In other cases WHT of 15% is applied.	There is no specific regime for banking sector.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
LUXEMBOURG	There is no WHT on interest under Luxembourg domestic law (except if the debt has very specific features).	Dividends on shares are in principle subject to a 15% WHT in Luxembourg except if they qualify for the participation exemption or if a reduction applies under the relevant double tax treaty. This is the standard WHT rate applicable to any Luxembourg taxpayer. The domestic WHT exemption will apply only if a 10% participation in the share capital (or EUR 1.2m acquisition price) of the distributing company is held (or commitment to hold) for an uninterrupted period of 12 months and the dividend is paid to a collective entity listed in the EU Parent-Subsidiary Directive or member of the EEA agreement and fully liable to a tax corresponding to Luxembourg CIT, a joint.-stock company tax resident in a country with which Luxembourg signed a double tax treaty and which is fully liable to a tax corresponding to the Luxembourg CIT, a joint-stock company tax resident in Switzerland and subject to corporate taxes in Switzerland without being exempt.	No

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
MALTA	A WHT of 35% on the gross interest may apply (in certain determined instances the Revenue may provide for authorization for a lower WHT or for no WHT) in the case of payment by a Maltese incorporated or resident company of debenture interest or of interest on any other loan advanced to a company (including a bank) for a capital purpose (excluding interest on customer's deposits and current accounts). This is merely a provisional withholding of tax on account of the final tax liability due in respect of the recipient's chargeable income for the particular year (any excess withheld would be refundable and any under-deduction would have to be settled to the Revenue). An exemption from WHT, including the above, may apply in the case of payment of any interest to a non-Maltese-resident person (including a bank) subject to the satisfaction of certain statutory conditions.	There should be no WHT on the payment of a dividend to any person (including a bank) subject that (in certain instances) in the case where the recipient of the dividend is a non-Maltese-resident person (including a bank) such person is not owned and controlled by, directly or indirectly, nor acts on behalf of an individual/s who is/ are ordinarily resident and domiciled in Malta.	There are no special tax rules for banks in this respect.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
NETHERLANDS	No, The Netherlands does not levy a WHT on interest payments.	Yes, the payer of the dividend is in principle obliged to withhold 15% dividend WHT on dividend payments. This rate may be reduced by a Double tax treaty or due to the EU Parent/Subsidiary Directive. In addition an exemption to withhold the 15% WHT could apply in case of dividend distributions take place between two corporate entities established in the Netherlands (for example in case of a fiscal unity).	No
POLAND	Interest earned in Poland and paid to a Polish resident bank is not subject to WHT. Interest earned in Poland and paid to foreign resident bank may generally be subject to WHT at the standard rate of 20%, however reduced rates / exemptions resulting from Double Tax Treaties ("DTTs") may be applicable, and exemption resulting from Polish tax regulations implementing the Interest and Royalties Directive.	Dividends from Polish companies may generally be subject to the standard 19% WHT if paid to Polish or foreign resident. Reduced rates / exemptions from WHT resulting from DTTs may be applicable, as well as exemption resulting from Polish tax regulations implementing the Parent-Subsidiary Directive.	These are general rules, no specific regime for banks in the domestic tax regulations exist. However, specific regulations, in particular WHT exemptions, on interest paid to banks exist in some of the DTTs concluded by Poland.
PORTUGAL	Interest paid to a resident Bank is exempt from WHT. Interest paid to a non resident Bank is subject to WHT, except if paid by a resident Bank.	Yes	Interest paid to a company is generally subject to WHT, while interest paid to a resident bank is exempt from WHT. However, WHT is a mere payment on account for residents, so the final tax burden will be the same.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
ROMANIA	Yes, only if the beneficiary of the income (the Bank) is situated abroad.	Yes, irrespective of the place where the beneficiary of the income is situated.	Applies for all companies (not just banks). The general 16% WHT rate applicable for interest and dividend payments can be further reduced to the Double Tax Treaty rate or to nil based on EU Directives (i.e. Interest - Royalties for interest payments and Parent-Subsidiary for dividend payments), as implemented in the Romanian legislation.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
SLOVAKIA	-Interest received from a loan is considered income for a Slovak bank, taxable on an accrual basis at the corporate tax rate of 19%. -The WHT on interest received from a loan by a Slovak non-domestic bank is generally 19%, however the provisions of any respective double tax treaty should be applied. Under Slovak tax law, and consistent with the EU Directive on taxation of interest and royalty payments, interest from loans paid to a beneficiary owner resident in another EU country, is exempt from WHT if the following criteria are met: (i) ▪ the payer of the interest and the recipient of the interest are directly related via capital (minimum share of 25%) and ▪ the minimum shareholding period is 24 months before the day of interest payment. No WHT applies on interest received by a Slovak or Slovak non-resident bank from deposits on bank accounts.	Under Slovak domestic law , there is no WHT on dividends paid out of profits arising in 2004 or later years. In general, for dividends paid out of profits of 2003 or earlier years, a WHT of 19 % applies. This rate can be decreased to 0% for companies meeting specific criteria under the EU parent-subsidiary directive.	No other specific regimes, expect those already described, apply to banks.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
SLOVENIA	Interest paid to a bank abroad is subject to 15% WHT, unless reduced by an applicable double tax treaty or the provisions of the EU interest & royalty directive as implemented into Slovenian law.	Dividend paid to a bank abroad is subject to 15% WHT, unless reduced by an applicable double tax treaty or the provisions of the EU parent subsidiary directive as implemented into Slovenian law. Dividends are exempt from Slovene WHT if the recipient is an EU tax resident that is unable to obtain a tax credit for the WHT in its home country due to dividend income being exempt from tax in that country.	No. However, interest paid by Slovene banks is not subject to WHT unless paid to tax haven countries.
SPAIN	Interest is generally subject to WHT at the specific rate (currently 19%). Nevertheless interest paid to banks are exempt of WHT	Generally speaking dividend paid domestically is subject to WHT (currently 19%) except specific exemptions are applicable (for instance Corporate Tax Groups; deduction to avoid double taxation applicable; etc.). There are no specific rules for banks.	No, except the exemption mentioned for interest.
SWEDEN	No	No	No
UK	UK WHT does not apply to interest on an advance from a bank if that bank is within the charge to Corporation tax as respects the interest. However, there is also a general exemption from the requirement to withhold on interest payments between UK tax resident companies.	There is no UK withholding on dividends.	Yes – see comments re WHT on interest. There is additionally a general exemption for a bank making interest payments in the ordinary course of its business to a company (on payments to individuals withholding may be required).

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
CHINA	The interest paid to the Bank abroad by the payer resident in China should be subject to WHT; while the local interest payment to the local Bank should not subject to WHT.	The dividend paid to the Bank abroad by the China subsidiary should be subject to WHT. On the other hand, normally, the local Bank are not allowed to make equity investment, thus the dividend paid to local Bank is not included in this summary.	No, this regime is not specific to the bank sector. There is no specific WHT exemption or reduced rates for banks under PRC domestic tax regime. WHT exemption or reduced rates could be applicable under the relevant Double Tax Agreements, which applies to other sectors as well.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
SINGAPORE	On the assumption that the payer is a non-bank entity, interest paid to a non-resident bank (i.e. Singapore branch of a foreign bank or foreign bank) will be subject to WHT at the prevailing corporate tax rate (currently 17%). However, this rate will be reduced to 15% if such payments are not derived by the non-resident from any trade, business, profession or vocation carried on or exercised in Singapore and are not effectively connected with any permanent establishment in Singapore of that non-resident. This tax rate is the final tax payable, meaning the non-resident cannot file a tax return to claim expenses so as to obtain a refund of taxes. Further, interest payments made to a Singapore branch of a foreign bank will not be subject to WHT if the recipient has obtained a relevant waiver from the Singapore tax authorities.	Not applicable. Dividend payments by a Singapore company are not subject to WHT in Singapore.	Yes, the comments in the earlier columns apply to banks. In addition, the government has granted a remission of WHT on all interest and related payments made by approved banks in Singapore to their overseas branches, head offices or another branch outside Singapore. Based on the recent Singapore budget, it was announced that with effect from 1 April 2011, the banks and certain financial institutions will be exempted from WHT on interest and related payments made to all non-residents (other than permanent establishments in Singapore) so long as these payments are made for trade or business purposes. This exemption is for such payments made during the period 1 April 2011 to 31 March 2021.
SWITZERLAND	WHT of 35% is only due if the interest paid to a foreign bank s related to a bond or a bond like instrument issued by a Swiss resident issuer or if the Swiss debtor qualifies as a bank for Swiss WHT purposes (i.e. interest bearing debt of more than CHF 500'000 towards more than 20 creditors).	Dividend distributions of Swiss resident legal entities are subject to a 35% Swiss WHT	There is no special WHT regime for banks. Note however that interest paid by a Swiss bank is in general subject to Swiss WHT, however, there is an exemption for interest paid by a Swiss bank to another (Swiss or foreign) bank.

Country	Is interest paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (debtor or subsidiary) is resident in your country?	Are dividends paid to a Bank (whether situated in your country or abroad) subject to WHT if the payer (subsidiary) is resident in your country?	Is this regime specific to the bank sector? Are there specific WHT exemptions or reduced rates for banks?
USA	Yes	Yes	No. Additionally a bank is ineligible for an exemption from withholding tax on portfolio interest income if from a loan made in the ordinary course of its business.

ENCLOSURE 6: TAX TREATMENT OF GAINS AND LOSSES ON FINANCIAL FIXED ASSETS

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
AUSTRIA	Generally deductible	Generally deductible	Generally taxable	Generally taxable	Same treatment of banks as for companies in other sectors
BELGIUM	Capital losses incurred on a shareholding, both realized and unrealized, cannot be deducted, except for (realized) losses incurred upon liquidation of the company up to the amount of the loss of the paid-up share capital of that company.	Realized losses are generally deductible. Unrealized losses are deductible provided certain conditions are met.	Capital gains realized on the alienation of shares are (if certain conditions are fulfilled) fully exempt from Belgian CIT. This exemption, which is not only applicable for banks, only applies to the net gains. As far as a foreign shareholding is concerned, the exemption is granted with respect to shareholdings that meet the "subject-to tax condition". Unrealized capital gains on share will be generally taxable.	Generally taxable at the standard CIT rate.	Same treatment of banks as for companies in other sectors
BULGARIA	Losses from disposal of shares are treated under the general rules – i.e. included in	Losses from disposal of fixed assets are treated under the general rules – i.e. included in the annual financial result as ordinary	Gains from disposal of shares are treated under the general rules – i.e. included in the	Gains from disposal of fixed assets are treated under the general rules – i.e.	Unlike other companies banks recognize for tax purposes both realized and unrealized capital gains /

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	the annual financial result as ordinary business losses (no basket taxation). Expenses on revaluation are not recognized for tax purposes in the year when the expense was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). As a result realized losses are tax deductible, not realized are not. Stock exchange losses are not deductible.	business losses (no basket taxation). Expenses on revaluation of fixed assets are not recognized for tax purposes in the year when the expense was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). Special rules apply to revaluation of financial instruments. As a result realized losses are tax deductible, not realized are not.	annual financial result as ordinary business income. There is no separate taxation. Income on revaluation are not recognized for tax purposes in the year when the income was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). As a result realized gains are taxable, not realized are not Stock exchange gains are not taxable.	included in the annual financial result as ordinary business income. There is no separate taxation on capital gains on fixed assets. Income on revaluation of fixed assets are not recognized for tax purposes in the year when the income was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). As a result realized gains are taxable, not realized are not	losses (revaluation income / expenses are recognized in the period when incurred).
CYPRUS	Unrealized revaluations on shares are reversed as they have not been	If the fixed assets are used by the business, they could be eligible to a "Wear and Tear" allowance. Upon disposal, there is a balancing	Unrealized revaluations on shares are reversed as they have not been realized	If the fixed assets are used by the business, they could be eligible to a "Wear and Tear"	Same treatment of banks as for companies in other sectors

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	realized (i.e. unrealized losses are non deductible). The position of the tax authorities is that any realized losses relating to shares are non tax deductible for Cyprus Income tax purposes.	addition (taxed at 10%) at an amount equal to: the lower of [a) initial cost and b) proceeds] - tax written down value. If the amount is negative, then a balancing deduction is available. If the fixed asset is not eligible for "Wear and Tear" allowances, then a gain is not taxable and a loss is not deductible. Unrealized losses in relation to fixed assets are non deductible (unless there is a justifiable "permanent diminution" and not simply an unrealized revaluation in the value of the fixed asset in which case the treatment is as per the realized gains/losses).	(i.e. unrealized gains are non taxable). Realized gains are explicitly exempt from Cyprus income tax according to a relevant provision of the income tax legislation.	allowance. Upon disposal, there is a balancing addition (taxed at 10%) at an amount equal to: the lower of [a) initial cost and b) proceeds] - tax written down value. If the amount is negative, then a balancing deduction is available. If the fixed asset is not eligible for "Wear and Tear" allowances, then a gain is not taxable and a loss is not deductible. Unrealized gains are not taxable.	
CZECH REPUBLIC	Shareholdings to up to 20% are valued to fair value (unrealized loss may arise). At the same time shareholdings above	Realized and unrealized losses on fixed assets may be claimed in the tax return towards other income coming from the Czech Republic during the taxable period	Shareholdings to up to 20% are valued to fair value (unrealized gain may arise). At the same time shareholdings above	Under the Czech Income Taxes Act, realized and unrealized gains on fixed financial assets enter the general tax base for tax residents.	Same treatment of banks as for companies in other sectors

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	10% are exempt from taxation in case of sale, therefore unrealized loss on shareholding up to 10% is deductible. For shareholdings 10-20% loss is non-deductible. For shareholdings >20% it is not relevant, as the unrealized loss does not arise. Realized loss is deductible only in case of sale of shareholdings up to 10%. For non-residents losses are non-deductible.		10% are exempt from taxation in case of sale, therefore unrealized gain on shareholding up to 10% is taxable. For shareholdings 10-20% gain is non-taxable. For shareholdings >20% it is not relevant, as the unrealized gain does not arise. Realized gain is taxable only in case of sale of shareholdings up to 10%. For non-residents gains are taxable.	For non-residents, realized gain - income from the sale of assets - is considered to be Czech-source income subject to corporate income tax. Tax non-residents are obliged to file a corporate income tax return and tax the gain at the 19% standard corporate income tax rate. The Czech tax rules may be overruled by the applicable double tax treaty.	
DENMARK	Losses on portfolio shares (shareholdings less than 10%) are deductible under the mark-to market principle. No	Losses are in general deductible. However some losses may only be utilized against gains from a similar source. Both mark-to market and realization principles may apply. It depends on the asset	Generally taxable (unless shareholdings >10%). No ownership period distinction.	Gains are in general taxable. Both mark-to market and realization principles may apply. It depends on the asset in	Same treatment of banks as for companies in other sectors.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	ownership period distinction.	in question.		question.	
ESTONIA	There are no specific tax rules for shares. Both unrealized and realized losses reduce profits available for distribution. If profits are distributed, then these are subject to tax upon distribution.	There is no adjustment of accounting profits for net operating losses for tax purposes**.** Both unrealized and realized losses reduce profits available for distribution. If profits are distributed, then these are subject to tax upon distribution.	Any gains are included in the corporate profits of the company, but these are not subject to the corporate tax, until the company makes any distribution of profits. If unrealized gains are distributed, then these are subject to tax upon distribution. These rules are not specific for shares.	Any gains are included in the corporate profits of the company, but these are not subject to the corporate tax, until the company makes any distribution of profits. Distributable profits are determined based on financial statements drawn up in accordance with IAS/IFRS. There are no specific rules on the tax treatment of gains and losses on fixed assets. If unrealized gains are distributed, then these are subject to tax upon distribution.	Same treatment of banks as for companies in other sectors.
FINLAND	1) Unrealized capital losses on fixed assets shares are not tax	1) Unrealized capital losses on alienation of other fixed assets items are not tax deductible.	1) Unrealized capital gains on fixed assets shares are not taxable	1) Unrealized capital gains on other fixed assets items are not	The rules concerning tax exempt capital gains on fixed asset shares are

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	deductible. 2) Realized capital losses on fixed assets shares are not deductible if the corresponding gains would be exempt from tax (i.e. in case the requirements for capital gains tax exemption on shares would be met – see the column on right). Under other circumstances (i.e. in case the gain would not be tax-exempt), such losses are deductible. However, the losses may be offset only against taxable gains on the sale of fixed business assets shares within the same tax year or the 5 following years (please note that there are some restrictions	2) Realized losses on other fixed assets items are tax deductible according to general rules. Losses incurred on the alienation of business assets are considered to be part of ordinary losses (and can hence be set off against all taxable business income for subsequent ten years).	income. 2) Realized capital gains on fixed business assets shares are tax-exempt provided the following requirements are met**:** a) The shares have been continuously owned for at least one year in a period of time that has ended not more than one year before the sale; 2) The ownership share in the company whose shares are sold is at least 10 %; 3) The company whose shares are sold is a resident in Finland or another EU Member State, or in a tax treaty country; 4) The company whose shares are sold is not a real estate	taxable income. 2) Realized capital gains on other fixed assets items are regarded as ordinary business income and taxed accordingly.	applicable to limited companies, cooperative associations, savings-banks, and mutual insurance companies. In the light of the above, as regards of banks the rules are applicable to *banks established as limited companies. cooperative banks and savings banks.*

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	to the above rule – e.g. certain items may be deducted in determining the deductible loss). Furthermore, as an exemption to the above, capital losses incurred on disposal of shares in real estate companies are deductible from all business income (i.e. are considered to be part of ordinary losses and can hence be set off against all taxable business income for subsequent ten years). Please note that the tax rules discussed in this table apply only to companies conducting business activities and which are taxed in		company, or a company, whose activities consist mainly of owning and holding real estates; and 5) The company selling the shares is not a company carrying out private equity activities (as defined by BITA). Please note that there are some exceptions to the above main rule. If above conditions are not met capital gains from selling fixed asset shares are taxable as ordinary business income according to general rules.		

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	accordance with Business Income Tax Act, BITA (this should be the case as regards of banks).				
FRANCE	**Realized losses:** Short term capital losses on non qualifying shareholding are deductible from the CIT basis of the company. Long term capital losses are not deductible and can only be offset by long term capital gains realized over similar assets. Long term capital losses can not be used to offset long term capital gains when the losses derive from a qualifying shareholding that	Capital losses are deductible from the taxable basis. Unrealized capital losses on other assets can potentially be reflected by booking a tax deductible provision for depreciation of the asset. Other financial instruments (e.g. derivatives instruments) are to be valuated at the end of each fiscal year. The unrealized capital loss is thus tax deductible (subject to the straddle rules limitations).	**Realized gains:** A 95% exemption may apply on capital gains deriving from qualifying shareholding. Unrealized capital gains **Unrealized gains:** Not taken into account for computing the CIT basis. Finally, in accordance with article 209-0 A of the FTC, the shares in UCITS held by a company are to be valuated at the end of each fiscal year in accordance with the mark to market principle. Unrealized	Capital gains on fixed assets are taxable at CIT. Unrealized capital gains are not taken into accounts for computing the CIT basis. Other financial instruments (e.g. derivatives instruments) are to be valuated at the end of each fiscal year. The unrealized capital gain is thus taxable.	Same treatment of banks as for companies in other sectors; It should also be mentioned that according to article 38 *bis* A of FTC, listed stocks, receivables traded on a regulated market or instruments from the banking sector initially booked as "short term investments" (*"titres de transaction"*, i.e. assets purchased and sold for speculation purposes within a short timeframe - classically during the 6 months following their acquisition) are to be valuated at year end in application of the mark-to-market valuation

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	would have benefit from the participation exemption regime for capital gains. **Unrealized losses:** According to article 38.9 and 39.1 5° of the FTC, specific shareholdings (e.g. qualifying shareholding, participation in real estate companies, shares in specific UCITS…) are annually evaluated at their FMV. A provision can be booked should the valuation of the participation crystallize an unrealized capital loss. Depending on the nature of the shareholding valuated, the		gains are thus taxable.		principles. Unrealized capital gains that may be crystallised further to this valuation are then subject to CIT. Similarly, unrealized capital losses over this specific kind of assets are deductible and no provision could be booked to reflect such unrealized loss. Same tax treatment applies in case of sale of the asset or modification of its accounting status in the books of the bank (e.g. transfer from the "transaction asset" accounting item to the "placement asset" accounting item). Also, article 38 *bis* B of the FTC compels banks, that acquire fixed income (e.g. treasury bonds, tradable receivables

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	provision could either be deductible (e.g. investment securities) or not included (e.g. provision on qualifying shareholding) in the CIT basis. Finally, in accordance with article 209-0 A of the FTC, the shares in UCITS held by a company are to be valuated at the end of each fiscal year in accordance with the mark to market principle. Unrealized losses are thus tax deductible.				generating a fixed income…) for a price differing from their face/reimbursement value, to reflect this difference (either a gain or a loss) within their taxable results. The difference in value will be spread from the date of acquisition until the date of effective reimbursement of the asset.
GERMANY	Losses on shares as financial fixed assets are generally realized within the disposal of the shares and are not tax deductible. In case of an expected permanent diminution	Losses on other financial fixed assets are generally realized within the disposal of the assets and are generally fully deductible. Moreover, in case of an expected permanent diminution in value the fixed assets may be depreciated for tax purposes, which generally	Gains on shares as financial fixed assets are generally realized within the disposal of the shares and are at 95% tax exempt. Unrealized gains have no impact on the	Gains on fixed assets are generally realized within the disposal of the assets and are fully taxable. Unrealized gains have no impact on the taxable income.	Yes - Provided the financial assets have not to be allocated to the financial trading assets of the bank.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	in value the share may be depreciated in the tax balance sheet. However, also this loss is not deductible for tax purposes.	results in a deductible loss.	taxable income.		
GREECE	Losses arising from the sale of listed and non-listed shares are not recognized as tax deductible; they are booked in a special reserve account to be offset against realized gains arising from the sale of listed shares. Unrealized losses from the valuation of shares are also booked in the above reserve account to be offset against realized gains from the sale of listed shares.	Losses arising upon disposal of fixed assets are treated as tax deductible expense. Unrealized losses are not, in general, recognized as tax deductible. Unrealized losses from the valuation of bonds are also booked in the above reserve account to be offset against realized gains from the sale of listed shares.	Realized gains from sale of non listed shares are treated as taxable income. Realized gains from sale of listed shares, initially acquired until 31/12/2011 are booked in a special reserve account to be offset against realized losses from sale of shares and unrealized losses from shares and bonds. Realized gains from the sale of listed shares, initially acquired as of 1/1/2012 shall be treated as taxable income.	Gains arising upon disposal of fixed assets are treated as taxable income. Unrealized gains are treated as taxable income, if booked in the accounting books.	Same treatment of banks as for companies in other sectors. The only difference is that Banks in specific are obliged to submit a respective tax return on the last day of the ninth month (i.e. September 30th) from the end of the fiscal year, in which the special reserves were formed, so as to pay tax at the standard CIT rate on the special reserves balance. Therefore, for Banks the taxation is effectively deferred for a few months. Other companies do not file this return.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
HUNGARY	Realized and non-realized losses are generally deductible, although, there are certain exceptions: 1) Loss realized on the sale / contribution in-kind of a registered shareholding (min 30% held for min 1 year and registered with the Tax Authority within 30 days of acquisition) are not deductible from the tax base. 2) Non-realized foreign exchange losses can be treated tax neutral until the share is cancelled from the books.	Realized and non-realized losses are generally deductible. However, non-realized foreign exchange losses can be treated tax neutral until the asset is cancelled from the books.	Realized and non-realized gains are generally taxable, although there are certain exceptions: 1) Gains realized on the sale / contribution in-kind of a registered shareholding (min 30% held for min 1 year and registered with the Tax Authority within 30 days of acquisition) are not taxable. 2) Non-realized foreign exchange gains can be treated tax neutral until the share is cancelled from the books.	Realized and non-realized gains are generally taxable. However, non-realized foreign exchange gains can be treated tax neutral until the asset is cancelled from the books.	Same tax rules apply for banks as for companies in other sectors. In general there are no differences in the accounting treatment of realized or unrealized gains/losses on financial trading assets and financial fixed assets if banks and non-banking enterprises are compared.
IRELAND	Capital Gains Tax is levied on a realized basis only, except where shares are deemed to be of	Losses arising on the disposal of fixed assets (i.e. non-wasting assets) are subject of the Capital Gains tax regime, therefore capital losses are available for set off, provided the capital loss arises in	Capital Gains Tax is levied on a realized basis only.	Gains arising on the disposal of fixed assets (i.e. non-wasting assets) are subject to capital gains tax at the rate of	The regime is the same for all classes of companies.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	negligible value. In that case the unrealized loss is allowed.	either the same accounting period as the capital gain or in a preceding accounting period; capital losses cannot be carried back against capital gains arising in a preceding period. Capital Gains Tax is levied on a realized basis only.		25%. The assets are the subject of the Capital Gains tax regime, therefore capital losses are available for set off, provided the capital loss arises in either the same accounting period as the capital gain or in a preceding accounting period. Capital Gains Tax is levied on a realized basis only.	
ITALY	For IAS adopters, realized losses are not tax deductible because of the PEX rules apply. Realized losses are tax deductible only if the Participation Exemption conditions are not met.	For IAS adopters, losses realized or unrealized on financial fixed assets (other than shares) are tax deductible when recorded in the P&L.	For IAS adopters, realized gains are taxed on 5% of their amount (PEX rule). Realized gains are fully taxed only if the Participation Exemption conditions are not met. Unrealized gains are	For IAS adopters, gains realized or unrealized on financial fixed assets (other than shares) are taxed when recorded in the P&L.	Same treatment applies to banks as IAS adopters. Please consider that for No IAS Adopter entities, different rules may apply.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	Unrealized losses are not deductible.		not taxed.		
LATVIA	Realized losses on sale of EU and EEA public securities are non-deductible. Realized losses on sale of other securities may be carried forward for 8 years and set against future gains from sale of such other securities. Unrealized losses on shares are non-deductible.	Realized losses on fixed assets are deductible, while unrealized losses on fixed assets are non- deductible.	Realized gains on shares are taxable, while unrealized gains on shares are non-taxable.	Realized gains on sale of EU and EEA public securities are non-taxable. Realized gains on sale of other securities are taxable. Unrealized gains on shares are non-taxable.	Same treatment of banks as for companies in other sectors
LITHUANIA	Realized losses are generally deductible, but may be utilized only against gains from a similar source. Not utilized losses may be carried forward for five years, provided that	Realized losses are generally deductible. Losses from derivatives may be utilized only against gains from a similar source. Not utilized losses from derivatives may be carried forward for five years. Other losses can be carried forward indefinitely. Unrealized losses (i.e. incurred on	Realized gains are non-taxable provided that holding exemption relief is satisfied (i.e. more than 25% of shares in a company established in EEA or in a country with which Lithuania has a	Realized gains are taxable. Unrealized gains (i.e. incurred on revaluation) are generally non-taxable. The exception is applied only for gains derived	Same treatment of banks as for companies in other sectors

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	they are incurred from the disposal of shares which are not subject to holding exemption relief. Not utilized losses incurred from the disposal of shares which are subject to holding exemption relief cannot be carried forward (they can be utilized only in a current year). For holding exemption relief requirements please refer to the box No. 3. Unrealized losses (i.e. incurred on devaluation) are non-deductible.	devaluation) are generally non-deductible. The exception is applied only for losses incurred on devaluation of derivatives held for hedging purposes – such losses are deductible.	DTT signed are held for not less than 2 years). In other cases realized gains are taxable. Unrealized gains (i.e. incurred on revaluation) are non-taxable.	on revaluation of derivatives held for hedging purposes – such gains are taxable.	
LUXEMBOURG	Losses on shares are fully tax deductible. Unrealized losses on shares are in principle tax deductible if	Losses on fixed assets are fully tax deductible. Unrealized losses on fixed assets are in principle tax deductible if recognized for accounting purposes (prudent	Participations held in qualifying companies may benefit from a tax exemption on the capital gain realized	Gains on fixed assets are fully taxable. Nevertheless, certain assets may qualify, under conditions, for	YES. This tax treatment is applicable to Banks as for any tax payer.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	recognized for accounting purposes (prudent approach).	approach).	upon disposal according to the participation exemption regime (same conditions as for article 166 LITL except that the acquisition price is EUR 6m instead of EUR 1.2m and recapture rules are not limited to the year in which the tax exempt gain is realized). Unrealized gains on shares are in principle not taxable by application of the valuation rules (art.23 LITL).	a roll-over relief (temporary neutralization) in case proceeds from the sale are reinvested in another qualifying asset (article 54 LITL). The capital gain will be taxed at least in case of disposal of the assets in which proceeds were reinvested. This roll-over relief is available for any taxpayer in Luxembourg and not only banks. Unrealized gains on fixed assets are in principle not taxable by application of the valuation rules (art.23 LITL).	

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
MALTA	Realized losses on the transfer of shares may be tax deductible subject to certain conditions. Trading losses (which are allowable for tax purposes subject to the conditions referred to above) may be set off against any chargeable income (subject to certain exceptions specified in the law) whilst capital losses (which are allowable for tax purposes subject to the conditions referred to above) may only be set off against those capital gains contemplated in the law. Allowable trading losses and allowable capital losses may be carried	If capital allowances (tax depreciation) were claimed on the particular fixed asset then, in general, upon the disposal (or if destroyed or put out of use) of such fixed asset the transferor should be required to prepare a balancing statement which would either result in an allowance (where the disposal value is less than the tax written down value) or a taxable charge (where the disposal value is higher than the tax written down value). The accounting gain/loss should be reversed for tax purposes. In the case where the particular fixed asset is caught by the Maltese income tax provisions regulating capital gains (e.g. transfer of immovable property), the transferor should be required to prepare a tax computation showing the capital gain/ loss in terms of the specific tax provisions (this computation would be over and above the aforesaid balancing statement depending on whether capital allowances were claimed on	Realized gains on the transfer of shares are in general taxable but there may be the possibility of a participation exemption under Maltese tax law subject to the satisfaction of a number of conditions. In respect of unrealized gains, the point of departure should be that such gains should not be taxable for Maltese tax purposes. However especially in the context of trading companies such as banks, if the particular shares should be treated as a trading asset (and subject that a consistent tax treatment is applied)	If capital allowances (tax depreciation) were claimed on the particular fixed asset then, in general, upon the disposal (or if destroyed or put out of use) of such fixed asset the transferor should be required to prepare a balancing statement which would either result in an allowance (where the disposal value is less than the tax written down value) or a taxable charge (where the disposal value is higher than the tax written down value). The accounting gain/ loss should be reversed for tax purposes. In the case where the particular fixed asset is caught by the	Same treatment of banks as for companies in other sectors

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	forward indefinitely. In respect of unrealized losses, the point of departure should be that such losses should not be tax deductible for Maltese tax purposes. However especially in the context of trading companies such as banks, if it can be shown that the particular shares should be treated as a trading asset then there may be an argument that the unrealized trading loss arising therefrom may still possibly be tax deductible on the assumption that any unrealized gains would be treated as taxable (and subject that a consistent tax	the asset). The capital loss (i.e. a loss derived from a capital asset and not from a trading asset) can only be tax deductible against a capital gain (where any deduction is actually allowed by law). The capital loss may be carried forward to future years indefinitely and absorbed against future capital gains (but not against trading gains/ profits). Hence the fact that there is no other capital gain during the particular year where a capital loss is realized should not mean that the capital loss is lost forever. In respect of unrealized losses, the point of departure should be that such losses should not be tax deductible for Maltese tax purposes. However especially in the context of trading companies such as banks, if it can be shown that the particular fixed asset should be treated as a trading asset then there may be an argument that the unrealized trading loss arising therefrom may still possibly be tax deductible on the assumption that	then there may be an argument that the unrealized trading gain arising therefrom may still possibly be taxable (subject to the possible applicability of the participation exemption – see above – where applicable). However this point is not specifically catered for by Maltese tax law and there are no written Revenue guidelines. Hence this point would need to be cleared in writing with the Maltese Revenue.	Maltese income tax provisions regulating capital gains (e.g. transfer of immovable property), the transferor should be required to prepare a tax computation showing the capital gain/ loss in terms of the specific tax provisions (this computation would be over and above the aforesaid balancing statement depending on whether capital allowances were claimed on the asset). The said capital gain should be taxable together with the other items of income. In respect of unrealized gains, the point of departure	

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	treatment is applied). However this point is not specifically catered for by Maltese tax law and there are no written Revenue guidelines. Hence this point would need to be cleared in writing with the Maltese Revenue.	any unrealized gains would be treated as taxable (and subject that a consistent tax treatment is applied). However this point is not specifically catered for by Maltese tax law and there are no written Revenue guidelines. Hence this point would need to be cleared in writing with the Maltese Revenue.		should be that such gains should not be taxable for Maltese tax purposes. However especially in the context of trading companies such as banks, if the particular fixed asset should be treated as a trading asset then there may be an argument that the unrealized trading gain arising therefrom may still possibly be taxable (and subject that a consistent tax treatment is applied). However this point is not specifically catered for by Maltese tax law and there are no written Revenue guidelines. Hence this point would need to be	

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
				cleared in writing with the Maltese Revenue.	
NETHERLANDS	Realized and unrealized losses incurred on shares should in principle be deductible for Dutch CIT purposes except for cases in which the Dutch participation exemption applies (short said shareholdings of 5% and more – and assuming certain other conditions are met).	Realized losses on fixed financial assets should in principle be deductible. The DCIT act also allows to claim a loss on an asset which is not yet realized (principle of prudence – "voorzichtigheidsprincipe").	Realized and unrealized capital gains on financial fixed assets should in principle not be subject to Dutch CIT assuming the Dutch participation exemption applies. Otherwise, the capital gain should be taxed upon realization (i.e. unrealized gains should not be taxable until realized in fact).	Realized capital gains on fixed financial assets should in principle be taxed. Unrealized gains should be taxed upon realization of the gain (i.e. when realized in fact).	Same treatment of banks as for companies in other sectors.
POLAND	Realized losses on shares are generally tax deductible. Unrealized losses on shares are not tax deductible.	As a rule, losses on fixed assets are tax deductible. Unrealized losses are not tax deductible.	Realized gains on shares are generally taxable. Unrealized gains on shares are not taxable.	The gain is subject to the general CIT rate (19%). There is no separate capital gains tax. Unrealized gains are not taxable.	Same treatment of banks as for companies in other sectors
PORTUGAL	Realized losses are included in the taxable income and generally deductible	Realized losses are included in the taxable income and generally deductible Unrealized gains or losses are	Realized gains are included in the taxable income and generally taxed, with the	Realized gains are included in the taxable income and generally taxed.	Same treatment of banks as for companies in other sectors

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	in 50%. Unrealized gains or losses are generally not considered for tax purposes.	generally not considered for tax purposes.	possibility of a reinvestment relief of 50%. Unrealized gains or losses are generally not considered for tax purposes.	Unrealized gains or losses are generally not considered for tax purposes.	
ROMANIA	Realized losses on fixed assets are treated as deductible for profit tax purposes. There is no basket taxation (e.g. losses on fixed assets can be offset against regular profits and vice-versa). The unrealized losses coming from unfavourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-deductible for profit	Realized losses on fixed assets are treated as deductible for profit tax purposes. There is no basket taxation (e.g. losses on fixed assets can be offset against regular profits and vice-versa). The unrealized losses coming from unfavourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-deductible for profit tax purposes	Realized gains on fixed assets are treated as taxable for profit tax purposes. The unrealized gains coming from favourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-taxable for profit tax purposes.	Realized gains on fixed assets are treated as taxable for profit tax purposes. The unrealized gains coming from favourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-taxable for profit tax purposes.	Same treatment of banks as for companies in other sectors

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	tax purposes.				
SLOVAKIA	Loss on sale of fixed assets is tax non-deductible under specific conditions. The revaluation of fixed financial assets is accounted through BS accounts and therefore not subject to taxation.	Loss on sale of fixed assets is tax non-deductible under specific conditions. The revaluation of fixed financial assets is accounted through BS accounts and therefore not subject to taxation.	Gains on the sale of financial assets should be subject to general income tax rate of 19%. The revaluation of fixed financial assets is accounted through BS accounts and therefore not subject to taxation.	Gains on the sale of fixed assets should be subject to general income tax rate of 19%. The revaluation of fixed financial assets is accounted through BS accounts and therefore not subject to taxation.	Same treatment of banks as for companies in other sectors
SLOVENIA	Losses on sales of shares are generally tax deductible. Revaluations of shares to fair value are also generally tax deductible, although provisions for impairments are not.	Losses on fixed assets are generally tax deductible as part of the tax base for CIT purposes. Unrealized losses on fixed assets are not tax deductible.	A gain on the sale of shares by a Slovene entity is taxable.	Gains on fixed assets are generally taxable as part of the tax base for CIT purposes. Unrealized gains arising from revaluations are generally taxable.	Same treatment of banks as for companies in other sectors
SPAIN	General rule establishes that losses obtained on shares are included on the taxable base (initially according to accounting principles).	Losses are generally deductible. In certain circumstances differences may apply between the accounting and the tax value of the assets (for instance for some unrealized losses, depending on the type of assets and some other circumstances). In those cases,	Gain obtained on shares is generally taxed (although tax credits to avoid double taxation are available, depending on several circumstances). In certain circumstances	Gain obtained on fixed assets are included on the taxable base (initially according to accounting principles) and subject to the general	Same treatment of banks as for companies in other sectors. Nevertheless, as accounting principles prevail, it should be taken into account that there are specific accounting rules for financial entities and,

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	Unrealized losses (for instance impairments) are tax deductible subject to several and specific rules (depending on the type of assets; relationship; listed vs unlisted shares; location of the issuer of shares; etc.).	unrealized losses would not be tax deductible.	differences may apply between the accounting and the tax value of the assets (for instance non-deducted impairments).	Corporate tax rate. In certain circumstances differences may apply between the accounting and the tax value of the assets .	consequently, it could be some differences between financial and non-financial entities as consequence of a different accounting rule.
SWEDEN	Realized losses are recognised for tax purposes unless subject to participation exemption. Unrealized losses are not recognised	Realized losses are deductible Unrealized losses are not deductible	Gains are recognised for tax purposes unless subject to participation exemption**.** Unrealized gains are not recognized.	Realized gains are taxable. Unrealized losses are not taxable	**T**he regime for banks is different. Other financial fixed assets than shares are generally subject tot a mark-to-market regime, causing unrealized as well as unrealized gains and losses to be recognised for tax purposes. The same regime is also applicable to shares, unless the shares are subject to participation exemption. The distinction between such shares and other shares is, as regards banks, complex and is partially unexplored.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
UK	Shares in subsidiaries -where the "substantial shareholdings exemption" applies (i.e., a shareholding of over 10% where certain other conditions regarding the subsidiary and disposing group are met) no tax deductible loss will arise. Other shares held on capital account are taxed under the capital gains tax regime, and losses will be realized on disposal. Losses may only be relieved against profits of a capital nature (and not against other income).	All debt finance (whether trading or non trading) is assessed to UK tax as income under the loan relationships code. Losses in relation to loan relationships are generally realized in accordance with their accounting treatment (although specific computational provisions apply to connected party lending).	Shares in subsidiaries - where the "substantial shareholdings exemption" applies (i.e., where a shareholding of over 10% is held and certain other conditions regarding the subsidiary and disposing group are met) gains will be exempt from tax. Other shares held on capital account are taxed under the capital gains tax regime, and gains will be realized on disposal. Any gains will be included in profits subject to corporation tax.	All debt finance (whether trading or non trading) is assessed to UK tax as income under the loan relationships code. Gains in relation to loan relationships are generally realized in accordance with their accounting treatment (although specific computational provisions apply to connected party lending).	The same treatment applies to banks as to other companies (although it is less common for a bank to hold shares, other than shares in subsidiaries, on capital account).
CHINA	Capital losses incurred on a	Losses incurred from fixed assets disposal could be deductible for	Capital gain derived from a shareholding,	Gains realized from fixed assets disposal	Same treatment of banks as for companies in other

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	shareholding, both realized and unrealized, cannot be deducted, except for (realized) losses incurred upon liquidation of the company up to the amount of the loss of the paid-up share capital of that company.	CIT if it is supported with special purpose report, subject to final assessment and approval of Chinese tax authority. Unrealized losses are generally not tax deductible.	both realized and unrealized, should be excluded from the taxable income for CIT purpose.	are liable to 25% CIT. Generally, unrealized gains could be excluded from taxable income for CIT purpose.	sectors.
SINGAPORE	Gains and losses of a revenue nature would be assessable and deductible respectively, whereas those of a capital nature are ignored for tax purposes (i.e. gains not brought to tax, losses not allowed for tax deduction). Strictly, gains will be taxed when they are realised, whereas	See comments under the column "Shares".	See comments under the column "Shares".	See comments under the column "Shares".	Same treatment of banks as for companies in other sectors

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	losses will be allowed a deduction when they are incurred. However, companies which adopt FRS 39 (the local equivalent of IFRS 39) in the preparation of their financial accounts may (subject to some exceptions) elect to report such gains and losses to tax based on the amounts reflected in the income statement.				
SWITZERLAND	Realized and unrealized losses generally tax deductible (according to the accounting treatment)	Realized and unrealized losses generally tax deductible (according to the accounting treatment)	Realized capital gains on the sale of participations exceeding 10% are subject to the participation relief, provided that the holding period exceeds one year. Other realized capital gains are taxable (according to the accounting	In principle, realized capital gains are taxable (according to the accounting treatment). Unrealized capital gains are generally not taxable (according to the accounting treatment; to the extent an unrealized gain leads	Generally same treatment, however, banks may apply the held to maturity principle and hedge accounting.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
			treatment). Unrealized capital gains are generally not taxable (according to the accounting treatment; to the extent an unrealized gain leads to a reversal of a value adjustment in the financial statements, such gain would be taxable).	to a reversal of a value adjustment in the financial statements, such gain would be taxable).	
USA	A realized loss on the disposal of such an asset is generally a capital loss and such loss can be deducted up to the amount of capital gain generated in the same tax year. An unrealized loss is generally not deductible. If the taxpayer is a dealer in securities or an electing trader in securities, it can deduct an unrealized	A realized loss on the disposal of such an asset is generally deductible as an ordinary expense. An unrealized loss is generally not deductible.	A realized gain on the disposal of such an asset is generally a capital gain and is taxable. An unrealized gain is generally not taxable. If the taxpayer is a dealer in securities or an electing trader in securities, the unrealized gain is generally taxable under the mark-to-market rules.	A realized gain on the disposal of such an asset is generally taxable with the amount equal to the depreciation previously taken generally subject to ordinary treatment, and the excess generally treated as a capital gain. An unrealized gain is generally not taxable.	Same treatment of banks as for companies in other sectors.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Others	
	loss under the mark-to-market rules.				

ENCLOSURE 7: TAX TREATMENT OF (FINANCIAL) TRADING ASSETS

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
AUSTRIA	According to the Austrian banking act financial trading assets may be recognized at the higher market value as at the balance sheet date. Realized and unrealized losses are tax deductible.	According to the Austrian banking act financial trading assets may be recognized at the higher market value as of the balance sheet date. Realized and unrealized losses are tax deductible.	According to the Austrian banking act financial trading assets may be recognized at the higher market value as of the balance sheet date. Realized gains are taxable. For tax purposes only appreciations up to the acquisition costs are tax effective.	According to the Austrian banking act financial instruments (not reported as fixed assets) are reported at acquisition costs in the case of a higher market value, this has to be reported in the notes of the financial statements. Realized gains are taxable. For tax purposes only appreciations up to the acquisition costs are tax effective.	Yes, these rules are applicable for banks.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
BELGIUM	Realized and unrealized tax losses are generally not tax deductible.	There are no specific tax rules for assets held for trading purposes. Generally, as they do not meet any conditions for tax exemption, their capital gains will be taxable and capital losses will be tax deductible.	With respect to shares, provided that the subject-to-tax condition of the participation exemption regime is met, realized capital gains can be 100% tax exempted. Unrealized capital gains on share will be taxable unless the 'intangible' condition is met.	There are no specific tax rules for assets held for trading purposes. Generally, as they do not meet any conditions for tax exemption, realized capital gains will be taxable. Unrealized capital gains will be taxable, unless the 'intangible' condition is met.	These rules apply equally for banks and for standard companies. Nevertheless, it is worthwhile mentioning that banks may have to apply the mark-to-market method for these assets held for trading purposes where for standard companies the lower of cost or market method ("LoCoM") is generally applied. As a consequence, unrealized gains may have to be booked in P&L and are subject to CIT.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
BULGARIA	Losses from disposal of shares are treated under the general rules – i.e. included in the annual financial result as ordinary business losses (no basket taxation). Expenses on revaluation are not recognized for tax purposes in the year when the expense was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). As a result realized losses are tax deductible, not realized are not. Stock exchange losses are not deductible.	Losses from disposal of fixed assets are treated under the general rules – i.e. included in the annual financial result as ordinary business losses (no basket taxation). Expenses on revaluation of fixed assets are not recognized for tax purposes in the year when the expense was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). Special rules apply to revaluation of financial instruments. As a result realized losses are tax deductible, not realized are not.	Gains from disposal of shares are treated under the general rules – i.e. included in the annual financial result as ordinary business income. There is no separate taxation. Income on revaluation are not recognized for tax purposes in the year when the income was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). As a result realized gains are taxable, not realized are not. Stock exchange gains are not taxable.	Gains from disposal of fixed assets are treated under the general rules – i.e. included in the annual financial result as ordinary business income. There is no separate taxation on capital gains on fixed assets. Income on revaluation of fixed assets are not recognized for tax purposes in the year when the income was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). As a result realized gains are taxable, not realized are not.	Unlike other companies banks recognize for tax purposes both realized and unrealized capital gains / losses (revaluation income / expenses are recognized in the period when incurred).

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
CYPRUS	Unrealized revaluations on shares are reversed as they have not been realized (i.e. unrealized losses are non deductible). The position of the tax authorities is that any realized losses relating to shares are non tax deductible for Cyprus Income tax purposes. Same treatment applies for other qualifying titles (including bonds, debentures, founders shares and rights thereon – the list also includes other titles).	Realized losses on trading assets (e.g. trading goods) are deductible. Unrealized losses in relation to trading assets are non deductible (unless there is a justifiable e.g. net realizable value permanent diminution and not simply an unrealized revaluation in the value of the trading asset).	Unrealized revaluations on shares are reversed as they have not been realized (i.e. unrealized gains are non taxable). Realized gains are explicitly exempt from Cyprus income tax according to a relevant provision of the income tax legislation. Same treatment applies for other qualifying titles (including bonds, debentures, founders shares and rights thereon – the list also includes other titles).	Realized gains on trading assets are taxable (e.g. trading goods). Unrealized gains in relation to trading assets are not taxable.	N/A

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
CZECH REPUBLIC	Gains are taxable and losses deductible (see Enclosure 6) Realized loss is non-deductible for non-residents	Gains are taxable and losses deductible (see Enclosure 6)	Gains are taxable and losses deductible (see Enclosure 6)	Gains are taxable and losses deductible (see Enclosure 6)	The treatment is the same for banks
DENMARK	Generally, losses would be deductible under the mark-to-market principle.	Both mark-to-market and realization principle may apply. It depends on the asset in question. Generally, the mark-to-market principle would apply to financial contracts. Generally, losses are deductible.	Generally, gains are taxable under the mark-to-market principle.	Both mark-to-market and realization principle may apply. It depends on the asset in question. Generally, the mark-to-market principle would apply to financial contracts. Generally, gains are taxable.	Same rules apply for banks.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
ESTONIA	The assets held for trading purposes must be accounted in accordance with IAS/IFRS. There are no specific rules on the tax treatment of such items. Both unrealized and realized losses reduce profits available for distribution. If profits are distributed, then these are subject to tax upon distribution.	Both unrealized and realized losses reduce profits available for distribution. If profits are distributed, then these are subject to tax upon distribution.	If unrealized gains are distributed, then these are subject to tax upon distribution. These rules are not specific for shares.	If unrealized gains are distributed, then these are subject to tax upon distribution.	Same treatment of banks as for companies in other sectors.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
FINLAND	We note that financial instrument is generally regarded as being held for trading purposes, if it is not subject to hedge accounting effectively meeting the conditions set out in IAS 39. 1) Unrealized losses on financial instruments held for trading purposes (including shares) which are recognized as expense in the profit and loss account are tax deductible (i.e. these are treated similarly for income tax and accounting purposes). 2) Realized losses on financial instruments held for trading purposes (including shares) are tax deductible.	Same treatments as with respect to shares (see column on left).	1) Unrealized gains on financial instruments held for trading purposes (including shares) which are recognized as income in the profit and loss account are taxable income (i.e. these are treated similarly for income tax and accounting purposes). 2) Realized gains on financial instruments held for trading purposes (including shares) are taxable income.	Same treatments as with respect to shares (see column on left).	The tax treatment as detailed in the columns on the left apply also to banks. In addition, the following rules apply to banks and credit institutions (but are not applicable to other entities). Unrealized gains and losses on ▪ financial instruments valued at fair market value on the basis of fair market value option; and ▪ hedging instruments used in fair market value hedging (effectively meeting the conditions set out in IAS 39) which are recognized as income/expense in the

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
FRANCE	**Realized losses:** Short term capital losses on non qualifying shareholding are deductible from the CIT basis of the company. Long term capital losses are not deductible and can only be offset by long term capital gains realized over similar assets. Long term capital losses can not be used to offset long term capital gains when the losses derive from a qualifying shareholding that would have benefit from the participation exemption regime for capital gains.	Capital losses are deductible from the taxable basis. Unrealized capital losses on other assets can potentially be reflected by booking a tax deductible provision for depreciation of the asset. Other financial instruments (e.g. derivatives instruments) are to be valuated at the end of each fiscal year. The unrealized capital loss is thus tax deductible (subject to the straddle rules limitations).	**Realized gains:** A 95% exemption may apply on capital gains deriving from qualifying shareholding. **Unrealized gains:** Not taken into account for computing the CIT basis. Finally, in accordance with article 209-0 A of the FTC, the shares in UCITS held by a company are to be valuated at the end of each fiscal year in accordance with the mark to market principle. Unrealized gains are thus taxable.	Capital gains on fixed assets are taxable at CIT. Unrealized capital gains are not taken into accounts for computing the CIT basis. Other financial instruments (e.g. derivatives instruments) are to be valuated at the end of each fiscal year. The unrealized capital gain is thus taxable.	Same treatment of banks as for companies in other sectors; It should also be mentioned that according to article 38 *bis* A of FTC, listed stocks, receivables traded on a regulated market or instruments from the banking sector initially booked as "short term investments" (*"titres de transaction"*, i.e. assets purchased and sold for speculation purposes within a short timeframe - classically during the 6 months following their acquisition) are to be valuated at year end in application of the mark-to-market valuation

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
	Unrealized losses: According to article 38.9 and 39.1 5° of the FTC, specific shareholdings (e.g. qualifying shareholding, participation in real estate companies, shares in specific UCITS…) are annually evaluated at their FMV. A provision can be booked should the valuation of the participation crystallize an unrealized capital loss. Depending on the nature of the shareholding valuated, the provision could either be deductible (e.g. investment securities) or not included (e.g. provision				principles. Unrealized capital gains that may be crystallised further to this valuation are then subject to CIT. Similarly, unrealized capital losses over this specific kind of assets are deductible and no provision could be booked to reflect such unrealized loss. Same tax treatment applies in case of sale of the asset or modification of its accounting status in the books of the bank (e.g. transfer from the "transaction asset" accounting item to the "placement asset" accounting item). Also, article 38 *bis* B of the FTC compels banks,

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
	on qualifying shareholding) in the CIT basis. Finally, in accordance with article 209-0 A of the FTC, the shares in UCITS held by a company are to be valuated at the end of each fiscal year in accordance with the mark to market principle. Unrealized losses are thus tax deductible.				that acquire fixed income (e.g. treasury bonds, tradable receivables generating a fixed income…) for a price differing from their face/reimbursement value, to reflect this difference (either a gain or a loss) within their taxable results. The difference in value will be spread from the date of acquisition until the date of effective reimbursement of the asset.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
GERMANY	Losses on shares as financial trading assets are generally realized within the disposal of the shares and are not tax deductible. In case of an expected permanent diminution in value the share may be depreciated in the tax balance sheet. However, also this loss is not deductible for tax purposes. Please note the special provisions for banks and financial institutions as outlined in the right column.	Losses on other financial trading assets are generally realized within the disposal of the assets and are generally fully deductible. Moreover, in case of an expected permanent diminution in value the fixed assets may be depreciated for tax purposes, which generally results in a deductible loss. Please note the special provisions for banks and financial institutions as outlined in the right column.	Gains on shares as financial trading assets are generally realized within the disposal of the shares and are at 95% tax exempt. Unrealized gains have no impact on the taxable income. Please note the special provisions for banks and financial institutions as outlined in the right column.	Gains on financial trading assets are generally realized within the disposal of the assets and are fully taxable. Unrealized gains have no impact on the taxable income. Please note the special provisions for banks and financial institutions as outlined in the right column.	Financial instruments held-for-trading by a bank or a financial institution are measured at fair value since 2010, as far as they are not part of a valuation unit. Additionally, a risk deduction has to be considered. Unrealized gains and losses increase or decrease the taxable income. Realized gains and losses on shares as financial trading assets increase or decrease the taxable income i.e. the 95% tax exemption is not applicable in case of shares held by a bank or a financial institution as trading assets. Correspondingly, losses resulting from a disposal of such shares are

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
GREECE	There are no general or special tax rules on assets held for trading purposes (see Enclosure 6).	There are no general or special tax rules on assets held for trading purposes (see Enclosure 6).	There are no general or special tax rules on assets held for trading purposes (see Enclosure 6).	There are no general or special tax rules on assets held for trading purposes (see Enclosure 6).	There are no general or special tax rules on assets held for trading purposes (see Enclosure 6).
HUNGARY	Realized and non-realized losses are deductible.	Realized and non-realized losses are deductible.	Realized and non-realized gains are taxable.	Realized and non-realized gains are taxable.	Same tax rules apply for banks as for companies in other sectors. In general there are no differences in the accounting treatment of realized or unrealized gains/losses on financial trading assets and financial fixed assets if banks and non-banking enterprises are compared.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
IRELAND	Accounts prepared under IFRS: treatment for tax purposes follows the accounts. Accounts prepared under Irish GAAP: in general the realisations basis applies, however it is permitted that 'mark to market ' may be applied by the accounting standard and in such cases Revenue will allow the company to elect to follow the accounting treatment for tax purposes. Such an election must be made at commencement and once made is irrevocable. Where a company is in the process of migration to IFRS then to the extent that an IFRS standard has been adopted, the tax	Where assets held for trading purposes are disposed of, any loss arising on disposal forms part of the company's allowable expenses.	Where assets held for trading purposes are disposed of, any profit arising on disposal forms part of the company's trading income.	Where assets held for trading purposes are disposed of, any profit arising on disposal forms part of the company's trading income.	The same treatment applies to banks and companies of other sectors

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
ITALY	For IAS Adopters, realized and unrealized losses are tax deductible when recorded in the P&L.	For IAS Adopters, realized and unrealized gains are taxed when recorded in the P&L.	For IAS Adopters, realized and unrealized losses are tax deductible when recorded in the P&L.	For IAS Adopters, realized and unrealized gains are taxed when recorded in the P&L.	Same treatment applies to banks as IAS adopter. Please consider that for No IAS Adopter entities, different rules may apply.
LATVIA	Realized losses on sale of EU and EEA public securities are non-deductible. Realized losses on sale of other securities may be carried forward for 8 years and set against future gains from sale of such other securities. Unrealized losses on shares are non-deductible.	Losses from other assets are deductible when realized.	Realized gains on sale of EU and EEA public securities are non-taxable. Realized gains on sale of other securities are taxable. Unrealized gains on shares are non-taxable.	Realized gains from other assets are taxable.	These general rules apply to all sectors, including the Financial Sector.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
LITHUANIA	Realized losses are generally deductible, but may be utilized only against gains from a similar source. Not utilized losses may be carried forward for five years, provided that they are incurred from the disposal of shares which are not subject to holding exemption relief. Not utilized losses incurred from the disposal of shares which are subject to holding exemption relief cannot be carried forward (they can be utilized only in a current year). For holding exemption relief requirements please refer to the box No. 3. Unrealized losses (i.e. incurred on devaluation) are non-deductible.	Realized losses are generally deductible. Losses from derivatives may be utilized only against gains from a similar source. Not utilized losses from derivatives may be carried forward for five years. Other losses can be carried forward indefinitely. Unrealized losses (i.e. incurred on devaluation) are generally non-deductible. The exception is applied only for losses incurred on devaluation of derivatives held for hedging purposes – such losses are deductible.	Realized gains are non-taxable provided that holding exemption relief is satisfied (i.e. more than 25% of shares in a company established in EEA or in a country with which Lithuania has a DTT signed are held for not less than 2 years). In other cases realized gains are taxable. Unrealized gains (i.e. incurred on revaluation) are non-taxable.	Realized gains are taxable. Unrealized gains (i.e. incurred on revaluation) are generally non-taxable. The exception is applied only for gains derived on revaluation of derivatives held for hedging purposes – such gains are taxable.	The same treatment for banks as for companies in other sectors.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
LUXEMBOURG	Losses on shares are fully tax deductible. Unrealized losses on shares are in principle tax deductible if recognized for accounting purposes (prudent approach).	There are no specific rules for assets held for trading purposes. Generally, as they do not meet any conditions for tax exemptions, their capital gains will be taxable and capital losses will be tax deductible. Interest received and dividends received before disposal should also be fully taxable. Unrealized losses on assets held for trading purposes are in principle tax deductible if recognized for accounting purposes (prudent approach).	Participations held in qualifying companies may benefit from a tax exemption on the capital gain realized upon disposal according to the participation exemption regime (same conditions as for article 166 LITL except that the acquisition price is EUR 6m instead of EUR 1.2m and recapture rules are not limited to the year in which the tax exempt gain is realized). Generally, as they do not meet any conditions for tax exemptions, their capital gains will be taxable. Unrealized gains on shares are in principle not taxable by application of the valuation rules (art.23	There are no specific rules for assets held for trading purposes. Generally, as they do not meet any conditions for tax exemptions, their capital gains will be taxable and capital losses will be tax deductible. Interest received and dividends received before disposal should also be fully taxable. Unrealized gains on assets held for trading purposes are in principle not taxable by application of the valuation rules (art.23 LITL).	YES. This tax treatment is applicable to Banks as for any tax payer.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
MALTA	Realized losses on the transfer of shares held as trading assets may be tax deductible subject to certain conditions. Trading losses (which are allowable for tax purposes subject to the conditions referred to above) may be set off against any chargeable income (subject to certain exceptions specified in the law). Allowable trading losses may be carried forward indefinitely. In respect of unrealized trading losses, the point of departure should be that such losses should not be tax deductible for Maltese tax	Realized losses arising from trading assets should in general be tax deductible subject to certain conditions including that if they were a gain they would have been brought to charge to tax. It is assumed that such trading assets would not qualify for capital allowances (tax depreciation) but this point may need to be verified on a case by case basis. In respect of unrealized losses, the point of departure should be that such losses should not be tax deductible for Maltese tax purposes. However especially in the context of trading companies such as banks, if it can be shown that the particular asset should be treated as a trading asset then there may be an argument that	Realized gains on the transfer of shares are in general taxable but there may be the possibility of a participation exemption under Maltese tax law subject to the satisfaction of a number of conditions. In respect of unrealized gains, the point of departure should be that such gains should not be taxable for Maltese tax purposes. However especially in the context of trading companies such as banks, if the particular shares should be treated as a trading asset (and subject that a consistent tax treatment is	Realized gains arising from trading assets should in general be taxable but it would be advisable that one would consider the nature of the gain on a case by case basis. It is assumed that such trading assets would not qualify for capital allowances (tax depreciation) but this point may need to be verified on a case by case basis. In respect of unrealized losses, the point of departure should be that such losses should not be tax deductible for Maltese tax purposes. However	A bank is generally treated as carrying on a trading activity and consequently the income generated thereby is normally treated as trading income. In respect of assets which are held as trading assets by the bank, there are no special tax rules outlining the tax treatment thereof and hence trading income/ gains arising from such trading assets should in general be subject to tax in the normal manner. Naturally it would be advisable that each case would be analysed on its own merits so as to ascertain the precise Maltese income tax treatment in the

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
	purposes. However especially in the context of trading companies such as banks, if it can be shown that the particular shares should be treated as a trading asset then there may be an argument that the unrealized trading loss arising therefrom may still possibly be tax deductible on the assumption that any unrealized gains would be treated as taxable (and subject that a consistent tax treatment is applied). However this point is not specifically catered for by Maltese tax law and there are no written Revenue guidelines.	the unrealized trading loss arising therefrom may still possibly be tax deductible on the assumption that any unrealized gains would be treated as taxable (and subject that a consistent tax treatment is applied). However this point is not specifically catered for by Maltese tax law and there are no written Revenue guidelines. Hence this point would need to be cleared in writing with the Maltese Revenue.	applied) then there may be an argument that the unrealized trading gain arising therefrom may still possibly be taxable (subject to the possible applicability of the participation exemption – see above –where applicable). However this point is not specifically catered for by Maltese tax law and there are no written Revenue guidelines. Hence this point would need to be cleared in writing with the Maltese Revenue.	especially in the context of trading companies such as banks, if it can be shown that the particular asset should be treated as a trading asset then there may be an argument that the unrealized trading loss arising therefrom may still possibly be tax deductible on the assumption that any unrealized gains would be treated as taxable (and subject that a consistent tax treatment is applied). However this point is not specifically catered for by Maltese tax law and there are no written Revenue guidelines. Hence this point would	particular circumstances. One point which may be noted is that if the assets are treated as trading assets for tax purposes then the capital gains provisions (taxation but also exemption provisions) should not be applicable in respect of gains arising from such assets. In other words, the provisions of the tax law regulating capital gains only apply in the case of "capital assets". If the particular asset is held as a trading asset then the capital gains provisions (both in respect of the taxing provisions and also in respect of any tax exemptions which may apply under such capital

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
	Hence this point would need to be cleared in writing with the Maltese Revenue.			need to be cleared in writing with the Maltese Revenue.	gains provisions) would not apply. Naturally any trading income arising therefrom should in general be taxable under the normal (i.e. not capital gains) tax provisions.
NETHERLANDS	Realized and unrealized losses incurred on shares should in principle be deductible for Dutch CIT purposes except for cases in which the Dutch participation exemption applies (short said shareholdings of 5% and more – and assuming certain other conditions are met).	Realized losses on (financial) trading assets should in principle be deductible. The DCIT act also allows to claim a loss on an asset which is not yet realized (principle of prudence – "voorzichtigheidsprincipe").	Realized and unrealized capital gains on (financial) trading assets should in principle not be subject to Dutch CIT assuming the Dutch participation exemption applies. Otherwise, the capital gain should be taxed upon realization (i.e. unrealized gains should not be taxable until realized in fact).	Realized capital gains on (financial) trading assets should in principle be taxed. Unrealized gains should be taxed upon realization of the gain (i.e. when realized in fact).	Same treatment of banks as for companies in other sectors;

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
POLAND	Realized losses on shares are generally tax deductible. Unrealized losses on shares are not tax deductible.	General rules apply, i.e. any valuation is, as a rule, tax neutral and the tax result is calculated as the difference between the sale price and the expenses made on acquisition of the securities. Interest is taxed on cash basis. However, if the taxpayer (a financial or non-financial institution) has chosen the so-called "accounting method" of foreign exchange recognition for CIT purposes and valuation of foreign currency securities is treated as "FX differences" for the accounting purposes, then the valuation of these securities can be considered a revenue or a cost for tax purposes as well.	Realized gains on shares are generally taxable. Unrealized gains on shares are not taxable.	General rules apply, i.e. any valuation is, as a rule, tax neutral and the tax result is calculated as the difference between the sale price and the expenses made on acquisition of the securities. Interest is taxed on cash basis. However, if the taxpayer (a financial or non-financial institution) has chosen the so-called "accounting method" of foreign exchange recognition for CIT purposes and valuation of foreign currency securities is treated as "FX differences" for the accounting purposes, then the valuation of these securities can be considered as a revenue or a cost for tax purposes as well.	No difference

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
PORTUGAL	The tax treatment follows the typical accounting treatment. The typical accounting treatment is the fair value through profit and loss accounts. The fair value is considered for tax purposes in case the financial instruments have an official price and, if the financial instrument is shareholdings, the participation does not exceed 5%. If it is not the case, fair value is not considered for tax purposes, and only realized losses are deductible.	The tax treatment follows the typical accounting treatment. The typical accounting treatment is the fair value through profit and loss accounts. The fair value is considered for tax purposes in case the financial instruments have an official price. Therefore, unrealized losses are considered for tax purposes.	The tax treatment follows the typical accounting treatment. The typical accounting treatment is the fair value through profit and loss accounts. The fair value is considered for tax purposes in case the financial instruments have an official price and, if the financial instrument is shareholdings, the participation does not exceed 5% . If it is not the case, fair value is not considered for tax purposes, and only realized gains are taxed.	The tax treatment follows the typical accounting treatment. The typical accounting treatment is the fair value through profit and loss accounts. The fair value is considered for tax purposes in case the financial instruments have an official price Therefore, unrealized gains are considered for tax purposes.	No differences

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
ROMANIA	From an accounting perspective, held for trading ("HFT") instruments are registered at market value. Such instruments are marked-to-market and the differences generated are included in the profit and loss ("P&L") accounts (i.e. income/expenses). From a tax perspective, the following rules should be observed: the unfavourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-deductible for profit tax purposes. Such differences become deductible upon realisation, e.g. sale of the financial assets.	From an accounting perspective, held for trading ("HFT") instruments are registered at market value. Such instruments are marked-to-market and the differences generated are included in the profit and loss ("P&L") accounts (i.e. income/expenses). From a tax perspective, the following rules should be observed: the unfavourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-deductible for profit tax purposes. Such differences become deductible upon realisation, e.g. sale of the financial assets.	From an accounting perspective, held for trading ("HFT") instruments are registered at market value. Such instruments are marked-to-market and the differences generated are included in the profit and loss ("P&L") accounts (i.e. income/expenses). From a tax perspective, the following rules should be observed : the favourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-taxable for profit tax purposes. Such differences become taxable upon realisation, e.g. sale of the financial assets.	From an accounting perspective, held for trading ("HFT") instruments are registered at market value. Such instruments are marked-to-market and the differences generated are included in the profit and loss ("P&L") accounts (i.e. income/expenses). From a tax perspective, the following rules should be observed the favourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-taxable for profit tax purposes. Such differences become taxable upon realisation, e.g. sale of the financial assets.	No differences, the tax treatment of the revaluation of HFT instruments mainly depends on the nature of such instruments (e.g. bonds issued on long term versus short term) and whether the differences are realized or not. In case the rules outlined are met, the unrealized expenses / revenues should be non-deductible/non-taxable for profit tax purposes.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
SLOVAKIA	The revaluation differences of assets held for trading are included in P&L for accounting purposes and are subject to corporate income tax. The loss from sale of such securities is tax non-deductible under specific conditions.	The revaluation differences of assets held for trading are included in P&L for accounting purposes and are subject to corporate income tax. The loss from sale of such securities is tax non-deductible under specific conditions.	The revaluation differences of assets held for trading are included in P&L for accounting purposes and are subject to corporate income tax. The income from sale of such securities is subject to income tax.	The revaluation differences of assets held for trading are included in P&L for accounting purposes and are subject to corporate income tax. The income from sale of such securities is subject to income tax.	Same treatment of banks as for companies in other sectors
SLOVENIA	Impairments of financial instruments are non deductible when accounted for, and deductible when realized, except for impairments of investments at fair value through profit and loss, which are deductible when booked. This is also the case for shares.	Impairments of financial instruments are non deductible when accounted for, and deductible when realized, except for impairments of investments at fair value through profit and loss, which are deductible when booked.	Gains on disposal of shares held as trading assets are taxable. Unrealized gains on trading assets are likely to be taxable when posted to income for accounting purposes.	Gains on disposal of financial trading assets are taxable. Unrealized gains on trading assets are likely to be taxable when posted to income for accounting purposes.	No differences – The tax treatment of assets held for trading purposes generally follows their IFRS accounting treatment as Slovenian tax law does not provide for any specific tax treatment for such items, and Slovenian banks prepare accounts under IFRS.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
SPAIN	General rule establishes that losses obtained on shares are included on the taxable base (initially according to accounting principles). Tax deductibility on impairments or depreciations is subject to specific rules.	Realized losses are generally deductible. Tax deductibility on impairments or depreciations is subject to specific rules.	Based on accounting principles. Income/gains obtained on shares are included on the taxable base (based on accounting principles) and subject to taxation at general Corporate Tax rate (although tax credits to avoid double taxation are available, depending on several circumstances). In certain circumstances differences may apply between the accounting and the tax value of the assets (for instance non-deducted impairments).	Based on accounting principles. Income/gains obtained on those financial assets are included on the taxable base (based on accounting principles) and subject to taxation at general Corporate Tax rate. In certain circumstances differences may apply between the accounting and the tax value of the assets.	Same treatment of banks as for companies in other sectors. Nevertheless, as accounting principles prevail, it should be taken into account that there are specific accounting rules for financial entities and, consequently, it could be some differences between financial and non-financial entities as consequence of a different accounting rule).

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
SWEDEN	As stock in trade - all gains and losses are taxable and deductible on a mark-to-market basis (i.e. unrealized), but may also be taxed on a realisation basis at the request of the tax payer	As stock in trade - all gains and losses are taxable and deductible on a mark-to-market basis, (i.e. unrealized), but may also be taxed on a realisation basis at the request of the tax payer	As stock in trade - all gains and losses are taxable and deductible on a mark-to-market basis, (i.e. unrealized), but may also be taxed on a realisation basis at the request of the tax payer.	As stock in trade - all gains and losses are taxable and deductible on a mark-to-market basis, (i.e. unrealized), but may also be taxed on a realisation basis at the request of the tax payer.	The same rules will apply to banks
UK	Shares held on trading account will generally be taxed in accordance with the UK GAAP or IFRS accounting treatment.	Bonds etc. held on trading account will generally be taxed in accordance with the UK GAAP or IFRS accounting treatment.	Shares held on trading account will generally be taxed in accordance with the UK GAAP or IFRS accounting treatment.	Bonds etc. held on trading account will generally be taxed in accordance with the UK GAAP or IFRS accounting treatment.	The treatment as outlined applies to any corporation which trades in financial assets, whether or not a regulated bank.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
CHINA	For assets held for trading purposes, generally CIT is reported following accounting standard (i.e. on accrual basis), but the market-to-market gain/loss could be excluded for CIT purpose whilst only realized gain/loss should be taxable/deductible for CIT purpose.	For assets held for trading purposes, generally CIT is reported following accounting standard (i.e. on accrual basis), but the market-to-market gain/loss could be excluded for CIT purpose whilst only realized gain/loss should be taxable/deductible for CIT purpose.	For assets held for trading purposes, generally CIT is reported following accounting standard (i.e. on accrual basis), but the market-to-market gain/loss could be excluded for CIT purpose whilst only realized gain/loss should be taxable/deductible for CIT purpose.	For assets held for trading purposes, generally CIT is reported following accounting standard (i.e. on accrual basis), but the market-to-market gain/loss could be excluded for CIT purpose whilst only realized gain/loss should be taxable/deductible for CIT purpose.	These rules apply equally for banks and for standard companies.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
SINGAPORE	Gains and losses from share trading are generally of a revenue nature in the hands of the companies that are trading shares in their ordinary course of business. Strictly, gains will be taxed when they are realized, whereas losses will be allowed a deduction when they are incurred. However, companies which adopt FRS 39 (the local equivalent of IFRS 39) in the preparation of their financial accounts may elect to report such gains and losses to tax based on the amounts reflected in the income statement.	See comments under the column "Shares".	See comments under the column "Shares".	See comments under the column "Shares".	Financial instruments are more likely to be trading (revenue) assets for banks as compared to non-Financial Sector. Banks which adopt FRS 39 in the preparation of their financial accounts may (subject to some exceptions) elect to report such gains and losses to tax based on the amounts reflected in the income statement.

Country	Realized and unrealized losses		Realized and unrealized gains		Does the tax treatment as detailed in the columns before also apply to Banks? Please detail if any specificities apply to Banks?
	Shares	Others	Shares	Shares	Others
SWITZERLAND	A mark-to market approach is applied for assets held for trading purposes under the current assets. Note in this respect that in principle the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP.	A mark-to market approach is applied for assets held for trading purposes under the current assets. Note in this respect that in principle the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP.	A mark-to market approach can be applied for assets held for trading purposes under the current assets. Note in this respect that in principle the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP.	A mark-to market approach can be applied for assets held for trading purposes under the current assets. Note in this respect that in principle the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP.	Generally same treatment as non-Financial Sector.
USA	Generally mark-to-market rule applies if the taxpayer is a dealer in securities or a trader in securities and makes a mark-to-market election.	If the asset fits into the broad definition of "security", generally mark-to-market rule applies if the taxpayer is a dealer in securities or a trader in securities and makes a mark-to-market election.	Generally mark-to-market rule applies if the taxpayer is a dealer in securities or a trader in securities and makes a mark-to-market election.	If the asset fits into the broad definition of "security", generally mark-to-market rule applies if the taxpayer is a dealer in securities or a trader in securities and makes a mark-to-market election.	General rule applies to banks as to companies in other sectors.

ENCLOSURE 8: TAX TREATMENT OF BAD AND DOUBTFUL DEBTS

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
AUSTRIA	No	Yes, provided certain conditions are met	No
BELGIUM	No	Yes, provided certain conditions are met	No
BULGARIA	No	Specific provisions required under BNB do not have a tax effect(not deductible/taxable) and are strictly intended for regulatory purposes	For banks provisions on financial instruments are tax deductible in the year when made
CYPRUS	No	Yes, provided certain conditions are met	No
CZECH REPUBLIC	No	Yes	Yes. There are special tax rules for creation of bank provisions against non-statute-barred receivables from credits. Banks may in the given year create tax deductible provisions up to 2% of all loan receivables towards these receivables (incl. accrued standard interest). The 2% is annual average balance calculated at the end of each month and 1 January. Only loans granted to EU companies are included into the base of 2% calculation and only to these loans tax provision may be created.
DENMARK	Only if the losses would be tax deductible at realisation	Only if tax deductible under general Danish tax rules, i.e. the loss must be ascertainable and identified and considered fully and undoubtedly irretrievable.	Banks are subject to special rules, whereby provisions for bad and doubtful debts must follow accounting principles.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
ESTONIA	Yes (since no taxation unless distribution)	Yes (since no taxation unless distribution)	No.
FINLAND	Only depository banks and other credit institutions are entitled to make a tax deductible doubtful debt provision annually under certain conditions (see the column on right).	No specific provisions are available but all companies (conducting business activities) are entitled to deduct a permanent/final loss in value of a loan receivable for tax purposes provided the loan receivable has also been written off in the accounts (please note that write-downs on intra-group loan receivables are not deductible as a main rule). In addition, depository banks and credit institutions may include e.g. loan/client specific provisions in certain cases in the general provision (within the limits of the general doubtful debt provision – see the column on right).	Depository banks and other credit institutions are entitled to make a tax deductible doubtful debt provision annually. This provision cannot exceed 0.6% of the amount of total receivables outstanding at the end of the tax year. Other restrictions apply as well. As discussed in the previous column, also specific provisions (related to certain client etc.) may be included in the general doubtful debt provision (within its limits).

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
FRANCE	Yes, provided certain conditions are met	Yes, provided certain conditions are met, and cannot be combined with the general provision	Articles 2 and 3 bis of the Appendix 4 of the FTC entitle banks and credit establishments to deduct a specific provision for default risks over middle and long terms loans granted. The amount of the specific provision is capped at: - 5% of the accounting benefit of the bank - 0.5% of the amounts of credits effectively used. A specific practice recognised by the FTA allows bank establishments to maintain the tax deductibility of certain accounting provisions related to assets (classically loans, bonds, notes) held in risky jurisdictions (“provision pour risque pays”).

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
GERMANY	General provisions may be recorded based on experienced date of the past. As a general rule a minor provision of 1% or 2% should always be acknowledged for tax purposes.	Specific provisions based on specific facts present on the balance sheet date substantiating the likelihood of the default are acknowledged for tax purposes.	Yes - special guidelines for general allowances for tax purposes in case of credit institutions have been issued by the German Ministry of Finance. According to the guideline the percentage for general provisions has to be computed by relating 60% of the average amount of bad debts (not exceeding the amount of specific provisions) to the average amount of credit risk of the preceding five years.
GREECE	Banks are entitled to deduct for tax purposes a general provision at the rate of 1% (or 2% for Investment Banks, the term is not clearly defined in Greek Law) on the annual average of their advances , these comprising capital and receivables except for doubtful or non-collective interest related to doubtful or non-performing advances, which are monitored off-balance sheet in memo accounts, loans to the State and State-owned enterprises or loans guaranteed by the State.	Yes, provided certain conditions are met. Specific provisions are booked for certain non-performing loans. These provisions should be utilised for respective write-offs within 8 FYs starting in the year within which they were booked. In case where these amounts are not written-off during the 8 FYs, the Bank should submit a supplementary Income Tax return and suffer tax on the non utilised amount, plus late payment penalties.	The calculation of the general and specific provisions mentioned herein applies only to Banks. Different tax provisions apply to the bad debts provisions of ordinary companies.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
HUNGARY	Expense accounted for bad debts are generally tax-deductible. Impairment created with respect to doubtful debts are not tax-deductible. Provisions (reserve created for various future costs and liabilities) are not tax-deductible.	Bad debts that are expired or cannot be enforced at Court are not deductible from the tax base. Specific provisions (i.e. reserves created on the basis of certain specific, not generally applicable regulation) shall be tax-deductible, however, the application of such provisions is rare outside the financial services sector.	<u>Bad debts:</u> No special rules. <u>Doubtful debts:</u> The impairment created with respect to doubtful debts from financial and investment services activity is a tax-deductible expense. <u>Specific provisions:</u> Specific provisions that were accounted for due to the special nature of the Financial Sector's activity e.g.: on bank risk are deductible from the tax base. General provisions for expected liabilities and future expenses (i.e. regarding the provisions not accounted for based on banks' special accounting rules) will be treated according to the general rules applicable.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
IRELAND	In case of accounts under IFRS, no distinction is made between general and specific provisions and the full provision per the accounts is allowed. Under Irish GAP, there is no allowance for general provisions.	In case of accounts under IFRS, no distinction is made between general and specific provisions and the full provision per the accounts is allowed. Under Irish GAP, specific provisions are deductible, provided certain conditions are met.	The same rules apply to all taxpayers.
ITALY	For banks: Yes, provided certain conditions are met.	For banks: Yes, provided certain conditions are met.	For banks, bad debt provisions on advances and loans are deductible, in each tax period, within the limit of 0.30% of the total value of credits recorded in the balance sheet. The amount of the devaluations that exceeds 0.30% is deductible in equal instalments during the eighteen subsequent tax periods. For other companies, bad debt provisions are deductible in each tax period within the limit of 0.5% of total nominal value of credits. Total provisions can't exceed 5% of total nominal value of credits.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
LATVIA	No	Yes	Banks are not allowed to deduct specific provisions on the following items -specific provisions for shares and other non-fixed income securities, investments into shares of related companies, own shares, losses due to theft, fixed assets and loans issued to persons in low tax jurisdictions.
LITHUANIA	General provisions (i.e. provisions for entire portfolio of doubtful assets) are generally non-deductible.	Specific provisions (i.e. provisions for a particular bad/doubtful debt) may be tax deductible, provided that specific requirements are met (e.g., debt was included into income in previous periods, specific evidence and documentation is obtained, etc.). These specific requirements are applied for non-financial institutions. For specificities applicable to banks please refer to the next box.	Yes. Banks are not subject to specific requirements applied to other companies from non-Financial Sector. Specific provisions for bad debts recorded by banks may be deducted to the extent allowed by the rules of the Bank of Lithuania. There is no requirement that debt should be included into income in previous periods for banks. Also there is no requirement to obtain specific evidence for banks.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
LUXEMBOURG	Provisions for doubtful debts on advances and loans are in principle tax deductible if recognized for accounting purposes. The main conditions for a provision to be tax deductible are to be linked to the business of the company and to be economically justified.	Yes, provided certain conditions are met. For example: • Value adjustments made under article 58 generally comply with valuation rules for tax purposes (i.e. valuation at acquisition cost or lower market value) and are in principle tax deductible. On the other hand, value adjustments according to article 62 are only made to take into account the inherent banking risk for certain type of assets and are in principle not tax deductible. • Risks and charges provisions booked according to article 31 of the amended Law of 17 June 1992 are in principle tax deductible as the loss is clearly identified and either likely or certain to occur but uncertain as to the amount or to the date. Besides, country risk provisions reflecting the temporary risk of recovery due to economic/political situation of the country of the debtor are also tax deductible. • A lump-sum provision for risk-weighted assets could also be booked by the banks and is tax deductible if it meets certain conditions (i.e. limitation to 1.25% of the qualifying risk weighted assets) according to the Instructions form the Director of the Luxembourg Tax Authorities dated 16 December 1997.	Risk and charges, lump-sum and AGDL provisions are specific to banks due to their activity and inherent risks.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
MALTA	No	No, however particular bad debts (which are not provisions, whether specific or otherwise) may be tax deductible provided certain conditions are met.	There are no special Maltese tax rules applicable for banks in this respect.
NETHERLANDS	Yes (provided certain condition are met)	Yes (provided certain condition are met)	No
POLAND	For banks: Yes, provided certain conditions are met. These regulations are specific for banks. Insurance companies also have the right for deductibility of technical provisions, under specific conditions. For other sectors, general provisions are not tax deductible.	For banks: Yes, provided certain conditions are met. For other sectors, provisions may be deductible under specific conditions as well, however only if the receivable due was previously recognized as a taxable revenue.	Deductibility of provisions created for loans and guarantees is provided for the banks only. The requirements for documenting the uncollectibility of loans are, in part, specific for the banks. For companies from other sectors, a provision for an uncollectible receivable may as a rule be tax deductible provided that its uncollectibility is properly documented and this receivable was a taxable revenue of the taxpayer.
PORTUGAL	No	Yes, provided certain conditions are met	Yes, conditions of tax-deductibility of specific provisions are less severe than for other companies, since for banks the aging of the debt is normally lower than in other companies. For example, a bank can achieve a 100% deduction in outstanding debt of 1 year, while a company can only deduct 100% upon 2 years.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
ROMANIA	Yes, provided certain conditions are met	Yes, there are certain specific provisions that are fully tax deductible (e.g. specific credit risk provisions, provisions for guarantees of good execution, technical reserves constituted by insurance companies, risk provisions for transactions on capital markets in accordance with the National Security Commission, specific provisions constituted by airlines companies etc)	Yes, specific provisions for credit risk constituted by banks and non-banking financial institutions in accordance with the National Bank of Romania 'rules are fully tax deductible. The deductibility for specific credit risk provisions is allowed only for banks and non-banking financial institutions, whereas for regular companies the general deductibility conditions should be followed.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
SLOVAKIA	No	Yes, provided certain conditions are met	Yes. Tax deductible expense is estimated based on the number of overdue days, the amount of bad debt provision created following the IFRS rules and the collateral amount, without taking into account interest provision, and: • For overdue between 361 and 720 days deductible expense is considered to be up to 20% of unpaid loan which exceeds the collateral value, • For overdue between 721 and 1080 days deductible expense is considered to be up to 50% of unpaid loan which exceeds the collateral value, • For overdue greater than 1080 days deductible expense is considered to be up to 100% of unpaid loan which exceeds the collateral value. Write-off of receivables could be treated as tax deductible expense in the amount of bad debt provision that would be treated as tax deductible following the conditions stated above.
SLOVENIA	Yes, if certain conditions are met.	Yes, if certain conditions are met.	Yes: general and specific provisions are tax deductible for banks, provided certain conditions are met. In particular, provisions for revaluations of loans are tax deductible up to the amounts set out in the Act regulating the banking activities.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
SPAIN	Generally no. Please see comments on the following schedules	Yes,(bad debt provisions) provided certain conditions are met	Yes, tax rules for the deductibility of bad debt provisions are more restrictive for banks. Broadly speaking, ordinary companies can deduct bad debt provisions after 6 months the first unpayment is due. On the contrary, Banking entities register bad debt provisions according to accounting rules stated by Central Bank. These rules state a minimum percentage of provision based on the elapsed time from the unpayment date. Tax rules for the deductibility of bad debt provisions for banks are based on those percentages. Regarding general provisions, these are not tax deductible for ordinary companies. However, banks, in general terms, can deduct the annual charge of these provisions up to the limit of 1% of the positive difference of granted qualifying loans generated in the year. In general terms, bad debt provisions hedged with guaranty on rem, loan granted to related entities, etc are not tax deductible (both in the case of banks and ordinary companies).

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
SWEDEN	No	Yes, fully deductible if based on facts supporting the risk assessment in the specific case	The same rules apply to banks, but due to the nature of their business (in particular the large number of debts and claims handled) it is likely that banks will more easily be able to claim deduction for provisions based on statistical methods instead of facts relating to each bad or doubtful claim.
UK	No	Yes, provided they relate to bad or doubtful debts to third parties	The rules described apply also to Banks.
CHINA	No, except for banks.	No, except for banks.	Yes, banks are allowed to claim CIT deduction on loan provision at a rate of 1% on the prescribed doubtful debts. Besides, loan provision with higher rate by category on the specific loans is also applicable.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
SINGAPORE	With the introduction of FRS 39, general and specific provisions for bad or doubtful debts will no longer be made. Impairment losses are recognised under certain circumstances as prescribed in the accounting standard. Impairment losses incurred on financial assets on revenue account will be allowed a deduction and any reversal amount will be taxed.	See comments under the column "Are general provisions tax deductible?"	Yes. In addition, banks which do not have a robust loss estimation process and are unable to provide for collective impairment under FRS 39 are required by the banking regulator to maintain a certain level of impairment provisions. As a concession, the amount of general provisions (computed based on a provisional formula provided in the tax legislation) will be deductible. An auditor's certification is required to support the deduction claim.
SWITZERLAND	Yes, within limitations.	Yes, but limited to the amount that can be justified from an economic perspective.	Yes, the safe harbour guidelines issued by the cantonal tax administration for banks may differ from the ones provided for the non-financial services sector and may e.g. state that the deductibility of general bad-debt provisions is more restrictive for banks.

Country	Are general provisions tax deductible?	Are specific provisions tax deductible?	Specificities applicable to banks? If yes, please briefly summarize.
USA	No	Yes, provided certain conditions are met. However, the deductibility of specific provisions against debt obligations (as opposed to trade receivables) is severely limited for non-banks.	1. Yes , banks and other regulated corporations that are subject to supervision by a federal authority may deduct specific provisions to the extent that a debt is charged-off in accordance with specific orders of the authority or if, upon audit by the authority, the authority confirms that the charge-off would have been ordered had it not been made voluntarily. (This is irrelevant if the Bank makes a conformity election, see point 3 below.) 2. Yes, the experience method applies for "small banks" defined as banks with less than $500,000 in average assets for the taxable year. 3. Yes, banks using the specific charge-off method are allowed to make a conformity election. This allows banks to deduct the specific provision in the tax year it is recorded, if either 1) it was recorded from a specific order of the bank's regulatory authority or 2) the charge-off corresponds to the bank's classification of the debt, in whole or in part, as a loss asset under applicable regulatory standards.

ENCLOSURE 9: CORPORATE TAXATION QUESTIONNAIRE TO EU MEMBER STATES

Austria	
A. General tax regime applicable to banks	
General comments	
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1. Banks as well as other corporations are subject to unlimited taxation in Austria for their entire (domestic and foreign) income. The standard corporate income tax rate is 25% and applies to all corporations (including banks) regardless of whether they retain earnings or distribute them. There are no other CIT rates applicable. There is an obligation to pay minimum corporate income tax for every full calendar quarter for which unlimited tax liability obtains. The amount of minimum corporate income tax differs for banks compared to other corporations. The annual minimum corporate income tax is EUR 5,452 for banking institutions. The annual minimum corporate income tax for non financial institutions is EUR 1,750 for limited liability companies and EUR 3,500 for stock corporations. 2. No 3. Generally, the corporate income tax base for banks is computed in the same way as for other corporations. Different tax calculations can apply to banks as there exist e.g. different accounting rules for financial instruments and CIT generally follows accounting. 4. Banking services (e.g. interest income) are in general tax exempt from Value Added Tax (VAT) with the loss of VAT recovery. The basis for the levy for financing the chamber of commerce is calculated differently for banks in Austria. All companies and independent entrepreneurs, who are a member of the chamber of commerce, are subject to the levy. Basically the

Austria	
	levy rate is 3 % based on the amount of input tax accumulated by invoices received. This calculation is applicable for all non-financial institutes. Banks calculate their basis for this levy on the gross total of commissions and the net total of interest income (excluding foreign business). An Austrian bank operating through branches in other countries would be charged for the assets/derivative trades of whole legal entity, i.e. including the branches
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1. The treatment is the same as for other companies. Banks may benefit from general tax relief rules like any other company (e.g. international participation exemption, etc). 2. Generally, in Austria there are no specific CFC anti-avoidance rules for the financial sector. In Austria, there are generally no specific thin cap rules in the strict sense but according to the Austrian Banking Act, a specific minimum equity is required for banks (according to Basel II). Are there special rules to avoid offshoring of profits? The treatment is the same as for other companies. In Austria, there are no specific rules to avoid offshoring of profits. In practice, however, the Austrian tax authorities try to prevent the offshoring of profits (e.g. regarding the forwarding of profits via offshore companies or the interposition of holding companies) by not recognizing such structures/constellations. 3. Generally, any financial company is covered by Austrian double tax agreements. However, some double tax agreements concluded by Austria provide for certain types of interest income generated by banks to be exempt from withholding tax or to be subject to a reduced withholding tax rate (e.g. DTT Thailand, Venezuela,

Austria	
	Turkey, Nepal, Ukraine, Iran, Romania, Algeria, Armenia, Cuba). Additionally, some double tax agreements concluded by Austria provide for loans of whatever kind granted, insured or guaranteed by the Oesterreichische Kontrollbank AG (the Austrian export credit agency) for purposes of promoting exports to be exempt from withholding tax or to be subject to a reduced withholding tax rate. 4. Generally, there are no specific rules for the taxation of subsidiaries and branches of banks. Generally, for branches of foreign banks working capital has to be attributed for taxation purposes only (e.g. based on the equity requirements imposed by the Austrian Banking Act) according to the OECD report on the attribution of profits to permanent establishments dated July 17, 2008. Transfer pricing issues with respect to affiliated companies/permanent establishments are treated according to the respective OECD guidelines. 5. Other specific tax regime applicable to banks: Bank Levy From 2011, banks in Austria are subject to a bank levy. The total levy imposed is divided into a levy imposed on capital assets (based on the unconsolidated balance sheet total) and a levy on derivative trades. All banks which are regarded as credit institutions under the Austrian Banking Act (Bankwesengesetz) are subject to those levies. Financial services institutions, like e.g. leasing companies and investment companies are therefore not in scope. Generally, Austrian branches of foreign banks are also subject to the bank levy. Generally, the tax on capital assets shall be calculated on a modified average unconsolidated balance sheet total according to Austrian GAAP. The applicable tax rate shall depend on the amount of the average unconsolidated balance sheet total: < EUR 1 billion: no bank levy (allowance) EUR 1 to 20 billion: 0,055% tax rate

Austria	
	> EUR 20 billion: 0,085% tax rate The balance sheet of 2010 is generally used for calculating the taxable base for the years 2011, 2012 and 2013. Starting 2014, the balance sheet total of the previous fiscal year shall be used. Concerning the levy on derivative trades, the law basically covers all derivatives including sold options, which are subject to a 0,013% tax based on their nominal value. There is no allowance for this levy. For the years 2011, 2012 and 2013 generally the average value of the fiscal year 2010 determines the tax base. Starting 2014 the average value of the previous fiscal year shall be used. The average value is calculated by using the quarterly values as of 31 March, 30 June, 30 September and 31 December. Those values have to be reported to the Austrian central bank. From 2011 to 2013 the tax base should only be adjusted and calculated according to previous year figures if the average balance sheet total and the average value of the derivatives change by 50 % or more. Banks have to self-assess the bank levy and need to make quarterly prepayments (first prepayment based on the 2010 balance sheet value was due on 31 January 2011). Additionally, an annual tax return has to be filed by 31 October of each year. Both types of bank levies are deductible for corporate income tax purposes. "Allowance" in this context means, that for banks whose modified average unconsolidated balance sheet is less than 1 billion euro no banking levy on capital assets accrues. For those whose modified average unconsolidated balance sheet is higher than 1 billion euro, 1 billion euro is exempt from banking levy on capital assets. Example 1: Calculation base for banking levy on capital assets is 300 million euro: no banking levy on balance sheet accrues. Example 2: Calculation base for banking levy on capital assets is 25 billion euro:

Austria	
	- 0 to 1 billion EUR: tax rate= 0; banking levy= 0 - 1 billion to 20 billion EUR: tax rate= 0,055%; banking levy= 10.450.000 EUR - 20billion to 25 billion EUR: tax rate= 0,085%; banking levy= 4.250.000 EUR - Total banking levy: 14.700.000 EUR
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1. The treatment is the same as for other companies. Interest paid is generally regarded as expenses for tax purposes. Dividends paid are not regarded as expenses for tax purposes but as allocation of profits. 2. The treatment is the same as for other companies. Interest received is generally regarded as taxable income. Dividends received may be tax exempt according to the regulations for the national participation exemption and the international participation exemption. However, the international participation exemption according to Sec 10 para 2 ACITA does not apply to dividends/shares in profit, capital gains, capital losses and other changes in value under the following conditions. ▪ The foreign company's main business focus is to (directly or indirectly) generate interest income, income from leasing of tangible or intangible assets and income from the disposal of shares/shareholdings. ▪ The taxation of the foreign company's income is not comparable to Austrian regulations with respect to the tax rate and the calculation of the tax base. 3. Generally, Austrian withholding tax (KESt) on dividends is at a rate of 25 %. The treatment is the same as for other companies. Generally, Austrian withholding tax (KESt) has to be withheld by the distributing company from dividends distributed unless special regulations apply (national exemption from the obligation to withhold

Austria	
	KESt on dividends in the case of 10 % holding over a period of 1 year; exemption from the obligation to withhold KESt according to the parent – subsidiary directive in the case of 10 % holding over a period of 1 year ; relief at source from withholding tax according to Austrian double tax treaties). 4. The treatment depends on the specific financial product but generally on an accrual basis (e.g. for zero-coupon bonds interest is periodically accumulated and considered in the value of the bond). 5. Generally, withholding tax on interest is only due if interest is paid by the bank. However, there are many exceptions. According to Sec 94 chiffre 3a Austrian Income Tax Act, no withholding tax has to be deducted by the bank obligated to such withholding on interest income from cash deposits and other receivables against banks if the creditor of the income is a domestic or foreign bank. Additionally, no WHT on interest has to be deducted by the bank if the beneficiary is a corporation and a declaration is submitted to the bank proving that the beneficiary is a corporation. Interest paid to foreign beneficiaries should not be subject to Austrian WHT provided that the respective documentation of the tax status is provided (limited tax liability). In other words, In order to get exempt from WHT on interest payments, non-resident beneficiaries have to substantiate their "non-resident status" (so called: tax status) with appropriate documents (e.g. Resident registration form, passport). No
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Generally, gains and losses on fixed assets are tax effective in Austria (= gains are taxable and losses are deductible)**.** The treatment for banks is generally the same as for any other company.

Austria	
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1.Assumption: Government bill and trade bill within the meaning of bonds. According to Sec 56 Austrian banking Act the difference between acquisition costs and the higher redemption value of bonds and other fixed interest securities may be reported as profit on a pro-rata basis. For tax purposes, this difference is reported as taxable income on a pro rata basis. According to the Austrian banking act, the difference between higher acquisition costs and the lower redemption value is deductible immediately but the Austrian administrative high court ruled that this difference amount generally has to be deducted on a pro rata basis for tax purposes. 2. According to the Austrian banking act, if financial instruments (not reported as fixed assets) are reported at acquisition costs in the case of a higher market value, this has to be reported in the notes of the financial statements. For tax purposes only appreciations up to the acquisition costs are tax effective.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i) In Austria, there are no minimum requirements for general provisions. (ii) General valuation adjustments on securities and loans (see above – (i)) are not tax effective (=deductible) in Austria if they refer to general risks regarding receivables and credits or general risks regarding the banking sector without allocating these risks to specific receivables or credits (lump sum provisions). For individual provisions see (iv). (iii) See (ii) Tax deductibility of general provisions. (iv) From a tax perspective, only individual provisions are tax deductible. On the asset side of the balance sheet banks may create/report valuation adjustments

Austria	
	on securities and loans. (v) Tax deductibility of specific valuation adjustments is only granted by the Austrian tax authorities if (at balance sheet date) specific risks can be allocated to separate specific receivables and the repayment has been stopped. It must be expected that a specific receivable (very likely) will not be repaid completely. Such risks may exist if ▪ The agreed repayment terms neglected ▪ Credit instalments are not settled permanently/ continuously ▪ The debtor reports a poor financial situation or poor liquidity ▪ Exchange rate losses are sustained General risks with respect to the banking sector are covered by the (not tax effective) annual transfer to the unallocated risk reserve which is obligatory for banks. By ruling of the Austrian administrative high court the mere outstanding of repayments or account overdraft does not justify (tax effective) specific valuation adjustments. (vi) See (v) Tax deductibility of specific provisions.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Yes. The treatment is the same as for other companies.

Austria	
H. Specific questions regarding banks	
2. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 3. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1. There are two provisions regarding discretion to under/over-state the book value of capital relating to Article 37 and 38 of the Directive 86/635/EEC: - Claims of credit institutions, securities except for those held as fixed assets or included in the trading portfolio, loans and advances to credit institutions as well as exposures to nonbanks may be recognised at a lower value than that which would result from the application of the provisions of the Commercial Code where necessary for reasons of prudence in light of the particular banking risks. The difference from the values which would be applied in accordance with the Commercial code must not exceed 4% of the total amount of the assets indicated. - Credit institutions may create a special item on the liability side of their balance sheets – "Fund for general banking risks" for the purpose of protection against general banking risks. This fund may include those amounts which the credit institution considers necessary to cover special banking risks for reasons of prudence. The credit institution must have unrestricted and immediate access to this fund for the purpose of offsetting losses. Both these accounting discretions are not tax deductible. 2. There are no differences for subsidiaries of non-domestic banks. The accounting practices mentioned under 1 are not applicable for branches of non-domestic banks.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	We are not aware of any information that actual practices differ from legal provisions.

Belgium	
A. General tax regime applicable to banks	
General comments	
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The standard CIT rate is 33,99% (including 3% of "crisis contribution"). The same CIT rate generally applies to all taxpayers (including banks). There are no local corporate income taxes. 2) No. 3) No, the rules of computing the tax base are generally the same for banks as for other legal entities. Different tax calculations can apply to banks as there exists e.g. different accounting rules for financial instruments and CIT generally follows accounting. 4) No
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of	1) There are no specific tax reliefs applicable to banks. The same tax reliefs (e.g. the Notional interest deduction, the participation exemption regime, the exemption for capital gains on shares, etc….) are applicable for banks and standard companies, but it can not be excluded that banks, because of their activities and their Balance sheet/ revenue structure, do enjoy more than other players from these tax reliefs. 2) The anti-avoidance rules are generally the same for all taxpayers: - No general thin cap rules. However, a debt-equity ratio may apply in the following cases: ▪ 7/1 debt-equity ratio, if interest is paid to taxpayers benefiting from a tax regime more advantageous than the Belgian one on the income received and to the

Belgium	
banks?	extent certain limits are exceeded; ▪ 1/1 debt-equity ratio, if interest is paid to a director or a person exercising similar functions (foreign company) and to the extent certain limits are exceeded. - Belgian tax law provides for a limitation of the deductibility of interest in case such interest exceeds the amount corresponding to the market interest rate taking into account the circumstances of the transaction (i.e. the at arm's length interest). However, these rules are not applicable for banks (i.e. for interest paid by Belgian banks as well as for interest paid to Belgian banks) since it is assumed in such cases that the interest is necessarily at arm's length. - No CFC rule. There exists an anti-abuse provision for transfer of cash, securities etc to non-residents benefiting from a favourable income tax regime but this anti-abuse provision does not apply specifically for banks. - There are no special rules regarding offshoring specifically dedicated to banks. 3) Generally, there are no exclusions specified for banks from DTTs (which are therefore normally treaty entitled). Some DTTs concluded by Belgium provide for a WHT exemption on interest if the interest is paid with respect to loans granted by banks (except sometimes where such loans are represented by bearer instruments). 4) Subsidiaries are subject to taxation on the general principles. Branches of foreign banks are generally subject to taxation on the same principles, with some exceptions regarding their non-resident status.
C. Tax treatment of interest and dividends	
	1) General rules apply. Interest paid is treated as a tax deductible cost (under certain conditions). Dividends are paid out of net income (=allocation of profits). Therefore

Belgium	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	dividends distributed are not tax deductible for the taxpayer. 2) General rules apply. Interest received is treated as taxable revenue. Dividends received are fully taxable except if they qualify for the participation exemption regime. Under this regime, 95% of dividends received are exempt from CIT provided the following conditions are met: ▪ participation condition: 10% or acquisition value of 2.5 MEUR*; ▪ minimum holding period: one year (full ownership); ▪ shares booked as "financial fixed assets"; Please note that following a formal request of the European Commission, a draft bill is currently pending at the chamber of representatives in which it is suggested to eliminate this qualitative condition; ▪ subject-to-tax condition to be complied with in the hands of the distributing company. *Previously, some of these conditions were not applicable for dividends distributed to banks (e.g. the participation condition). This differentiated treatment, in favour of banks, has been recently removed so that banks are now subject to the same conditions as standard companies. 3) Dividends are generally subject to a 25% WHT (15% provided certain specific conditions are met). In addition this WHT can be (further) decreased following certain specific exemptions/reductions provided by Belgian internal law (further to the implementation of the EU Parent-Subsidiary Directive) and/or DTTs concluded by Belgium. Finally, as regards to WHT on dividend distributions, no immediate exemptions proper to banks come to mind as opposed to other companies.

Belgium	
	As a general principle, a 15% WHT has to be levied when an interest is "attributed" or "made payable" by a Belgian company (the notions "made payable" or "attributed" mean that the interest is available for immediate collection by the beneficiary even if such interest has not yet been actually paid to the latter). Banks generally benefit from WHT exemptions on interest received from receivables and from debt securities where a similar WHT exemption generally only applies for standard companies on interest arising from receivables, which means that they may enjoy in this respect a cash-flow advantage for debt securities. However, this advantage has to be mitigated in practice since other WHT exemptions may apply for standard companies (e.g. the so-called X/N regime). 4) From an accounting point of view, interest on advances and on debt securities of all kind are generally reported on an accrual basis. The tax treatment follows the accounting treatment, thus taxation upon accrual. 5) As mentioned above, the general Belgian WHT on interest payments amounts to 15%. The Belgian internal tax law as well as DTT concluded by Belgium provide for several reductions and/or exemptions in this respect. Please note that such reductions/exemptions generally depend on certain conditions such as amongst others the status of the debtor, the status of the beneficiary and the nature of the underlying financial instrument generating interest income. In this respect and as already mentioned above, the Belgian domestic law provides for specific exemptions in case the debtor and/or the beneficiary is a bank. For instance a WHT exemption is available in case of interest paid: - on loans by a Belgian credit institution to credit institutions established abroad; - on loans by professional investors (basically all Belgian corporate investors) to credit institutions established in, inter alia, the European Economic Area or in a country which has concluded a DTT with Belgium.

Belgium	
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	General rules apply to banks: Gains are in principle taxable and losses in principle tax deductible. However, certain assets may qualify, under conditions, for a roll-over relief (temporary neutralization) in case proceeds from the sale are reinvested in another qualifying asset. This roll-over relief is available for any taxpayer in Belgium and not only for Banks. Other roll-over reliefs (for instance in case of restructurings under certain conditions) are available for banks under the same conditions as for standard companies. Capital gains realized on the alienation of shares are (if certain conditions are fulfilled) fully exempt from Belgian CIT. This exemption, which is not only applicable for banks, only applies to the net gains. As far as a foreign shareholding is concerned, the exemption is granted with respect to shareholdings that meet the "subject-to tax condition" as described above. Capital losses incurred on a shareholding, both realized and unrealized, cannot be deducted, except for (realized) losses incurred upon liquidation of the company up to the amount of the loss of the paid-up share capital of that company.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) In principle taxable as interest income on an accrual basis. 2) There are no specific tax rules for assets held for trading purposes. Generally, as they do not meet any conditions for tax exemption, their capital gains will be taxable and capital losses will be tax deductible. With respect to shares, provided that the subject-to-tax condition of the participation exemption regime is met, realized capital gains can be 100% tax exempted whereas losses are generally not tax deductible. These rules apply equally for banks and for standard companies. Nevertheless, it is worthwhile mentioning that banks may have to apply the markt-to-market method for these assets held for trading purposes where for standard companies the lower of cost

Belgium	
	or market method ("LoCoM") is generally applied. As a consequence, unrealized gains may have to be booked in P&L and are subject to CIT.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i), (ii), (iii) General provisions are not tax deductible. (iv), (v), (vi) Provisions for doubtful debtors are tax deductible provided certain conditions are met such as: ▪ The losses for which the provisions are accounted for must be deductible business losses and must only relate to specific receivables not represented by bonds or similar securities, either under nominative, bearer or dematerialised form; ▪ These losses must be individualized and clearly specified and the probability that the receivable will result in a loss must be clearly documented and result, for each receivable, from particular circumstances which have occurred during the taxable year. As a result, provisions reflecting a general risk are not acceptable. ▪ The provisions must have been accounted for at the end of the taxable period and their amounts must be included in one or more separate accounts; ▪ Certain specific reporting requirements need to be complied with.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	In principle yes. Please note however that this generally depends on the settlement of the stock option plan. Should a stock option – payment be equated with a capital loss on shares, such payment will in principle not be tax deductible. For any company (not only banks).

Belgium	
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) The accounting practices do not allow banks to use accounting discretion to under/over-state the book of their equity value. However, there could be some flexibility for the accounting treatment of financial products in the absence of precise rules and CIT generally follows accounting. 2) For the sake of completeness, please be informed that in relation to the Belgian notional interest deduction ("NID"), a specific tax deduction based on a notional interest calculation, a circular letter has been issued by the Belgian tax authorities providing a different calculation of the net equity (the basis of the NID calculation) for branches as opposed to subsidiaries. In practice however we experience that the circular letter, which generally provides for a less favourable treatment for branches, is generally not applied.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	We have not identified any actual practices that defer from legal provisions.

Bulgaria	
A. General tax regime applicable to banks	
General comments	No bank levies in Bulgaria, no financial activities taxes. We are not aware of any such pending proposals. Generally, banks are treated the same as non-finance companies for tax purposes in Bulgaria expect for the following: ▪ The taxable base for non-finance companies is calculated on the basis of the accounting result under the applicable accounting standards (IFRS). For financial institutions if there is a difference between the accounting result under the IFRS and the accounting result under the regulatory framework, the result under the regulatory framework will be valid for tax purposes. The regulatory framework usually imposes more rigid requirements for impairments of receivables to financial institutions compared to the IFRS. This is not more advantageous (the regulatory framework is under the control of the Bulgarian National Bank which adopts regulations governing the activities of the banks). ▪ Financial companies are obliged to recognise for tax purposes expenses / income originating from revaluations of financial assets in the year when the accounting income / expense is recognised (for companies outside the financial sector such income / expenses are not recognised for tax purposes in the year when incurred but they form temporary tax differences which are reversible upon certain conditions in future years – e.g. disposal of the asset or receivable, termination of the debtor, expiry of statute of limitations, etc.). ▪ Financial companies are required to add back / deduct in their annual corporate income tax returns income/expenses originating from revaluation of financial assets and liabilities reported directly into equity. The idea is that the tax treatment for financial institutions should not depend on the accounting approach – thus movements of held for sale securities reflected into equity are

Bulgaria	
	taxed in the year when incurred, though they do not have effect in the profit and loss account in this particular year. ▪ Interest expenses on banks are not subject to the thin capitalisation rules.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1 The Bulgarian CIT rate is 10% and is levied on the financial result of Bulgarian tax resident companies adjusted for tax purposes. The general CIT rate of 10% applies also for banks. There are no local taxes levied on income apart from CIT. The local taxes relate to possession of certain types of property or disposals with such property (e.g. real estate, vehicles, garbage collection fees) - they are the same for banks and other companies. 2 No, there is no special tax rate applicable for banks. 3 Yes. The main differences in the rules to compute the corporate tax base for banks as opposed to the rules applicable for the other companies described in Section A above, should be considered. 4 No, there is no turnover tax in Bulgaria.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits?	1 No, except for the following: ▪ Tax relief on bank interest income for individuals – individuals are exempt from personal tax on interest from EU banks. This merely concerns a personal income tax relief (no WHT, etc). ▪ Bulgaria implements the EU Interest and Royalties Directive. Bulgaria Accession Agreement to the EU provides that the Directive would be gradually

Bulgaria	
3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	implemented in the local legislation. The Directive applies for banks as well. As of 1 January 2011 interest payments to EU affiliated entities is subject to a reduced withholding tax rate of 5% (the general interest withholding tax rate is 10%). The Directive could be applied for affiliated companies subject to certain conditions: e.g. 25% shareholding for at least 2 years. The Directive would be fully implemented as of 1 January 2015 when the interest withholding tax on interest income accrued to EU affiliated shareholders would be lowered down to zero. ▪ In the area of withholding tax, non-Bulgarian EU entities (including banks) are entitled to claim a reduction of the withholding tax paid on gross basis by taking into account the corresponding attributable expenses incurred for the realisation of the income (i.e. to be taxed as if local companies compared to the gross taxation for WHT purposes). Under these rules EU based companies which pay WHT in Bulgaria may opt to submit a tax claim requesting taxation on a net basis (e.g.. the EU based company may want Bulgaria to tax the spread between interest income and interest and all related costs with 10% corporate tax and any excess up to the paid WHT which is not credited abroad to be refunded to the applicant). This option does not provide for special advantages for banks, as it applies for all companies, including banks. The regime is new and no practices yet. The relief could be applied for income realised as from 2010 onwards. 2 No. Just the general anti-avoidance rules and transfer pricing. The Bulgarian TP legislation is generally based on the OECD guidelines, although they are not explicitly referred to in the law. Bulgarian legislation does not contain explicit TP documentation requirements. However, internal guidelines of the tax authorities indicate what TP documentation might be required in the course of a tax audit. Allowed TP methods include: the Comparable Uncontrolled Price, Resale Minus, Cost Plus, Transactional Net Profit Margin and Profit Split methods. The Advance Pricing Agreement procedure is not available. In case the bank has a transfer pricing

Bulgaria	
	policy and supporting transfer pricing documentation, in case of a tax audit the Bulgaria revenue authorities are obliged to examine the prepared TP documentation first. 3 To the best of our knowledge the Bulgarian double tax agreements do not exclude financial companies. To the contrary some tax agreements provide more favourable conditions for banks – e.g. Belgium, Luxembourg, etc. For example, the double tax treaties with Belgium and Luxembourg provide for a maximum interest withholding tax rate of 10%, unless the interest derives from bank loans in which case the double tax treaty provides for 0% withholding tax. 4 No, subsidiaries and branches of banks are subject to the general tax regime applicable to all companies. If the subsidiary of a bank is a financial institution, the specific rules for banks as described in this paper would apply.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third	1) Interest expenses are tax deductible unless restricted under the thin capitalisation rules (not applicable to banks) or transfer pricing considerations. The thin capitalisation regime does not apply to banks under the Bulgarian corporate income tax act – i.e. banks are in more favourable position than other companies in this respect as no limitations for interest deductibility apply to them. The aim of thin capitalisation restrictions is to restrict debt financing. The bank's business is to attract deposits – that's why no thin capitalisation restrictions apply. In addition, the tax deductibility of interest expenses could be restricted under the general anti-avoidance rules which apply for banks as well. Under these rules in case a transaction is effected in such a way so that the effect is tax avoidance, the tax result of the companies is adjusted as if the transaction was market based. The anti – avoidance rules apply to transactions between unrelated parties as well. Paid dividends are treated as distributed from the retained earnings. In addition, as

Bulgaria	
party?	per the applicable legislative framework, banks are required to be joint stock companies (JSC). JSC may distribute dividends in case the net value of the bank's assets as per the audited financial statements plus the dividends to be distributed is not less than the amount of the registered capital plus the amounts of the Reserve funds and the other funds of the JSC. Dividend may be distributed to the amount of the retained earnings less current year and past years losses. Bulgaria has implemented the EU Parent Subsidiary Directive under which dividend distribution to EU shareholders is not subject to Bulgarian withholding tax. The Directive applies for banks as well. 2) No special regime applicable for banks. Interest income is treated as ordinary income subject to 10% CIT. Income from dividends distributed by Bulgarian/EU subsidiaries is exempt from CIT in Bulgaria. Outside this dividend is taxable at 10% CIT. 3) No special regime applicable for banks. Dividend income distributed by a Bulgarian bank to a Bulgarian / EU based shareholder is exempt from Bulgarian withholding tax. Double tax treaty relief may be applicable to dividends remitted to non-EU shareholders. 4) Interest on advances is generally subject to taxation upon accrual. The taxation of the interest on securities would depend on the specific kind of the security and should be estimated on a case by case basis. 5) Yes, interest paid to third non-resident recipients is subject to Bulgarian withholding tax at the rate of 10% (please note our comments on the EU Interest and Royalties directive in Section A2 above). No Bulgarian withholding tax is due in cases where a non-resident PE of a Bulgarian

Bulgaria	
	company pays interest to a third party.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	1) Gains and losses from disposal of fixed assets are treated under the general rules – i.e. included in the annual financial result as ordinary business income. There is no separate taxation on capital gains on fixed assets. This regime applies to banks and other companies alike. Income and expenses on revaluation of fixed assets are not recognised for tax purposes in the year when the expense / income was accounted for (a temporary tax difference is created instead which is reversible upon certain conditions, e.g. disposal of the asset). Special rules apply to revaluation of financial instruments.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) Amortised over the useful life of the instrument – here the tax treatment follows the accounting treatment. 2) Gains and losses from revaluation of assets held for trade are recognised for tax purposes in the year of reporting the respective gain/loss into equity.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i) Revaluations on doubtful debts for banks should be performed in accordance with the IRFS. The accounting expenses and gains from such revaluations are recognised for tax purposes in the same year. The Regulations of the Bulgarian National Bank provide for some minimum required provisions on bad debts but these provisions are for purely regulative purposes, they do not have a P&L effect and do not have a corresponding tax effect. These provisions do not appear in the books, that is why no question for tax deductibility.

Bulgaria	
	(ii) Provisions on financial instruments are tax deductible in the year when the provision was made. (iii) No limitations for deductibility on general provisions – tax treatment follows accounting treatment. Thus general provisions are tax deductible. (iv) The Regulations of the Bulgarian National Bank provide for some specific provisions for banks for the purposes of their capital adequacy. These provisions however are intended for strictly regulative purposes and do not have an accounting (not accounted in the P&L of Banks) or tax implications. (v)The specific provisions required under the BNB Regulations do not have a tax effect (=are not deductible/taxable) and are strictly intended for regulative purposes. (vi)The specific provisions required under the BNB Regulations do not have a tax effect and are strictly intended for regulative purposes.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Generally, if the proceeds from a stock option plan are administered through the local payroll the benefit is taxed with the applicable personal income tax rate (10%). The respective expenses on the proceeds accrued by the banks should be tax deductible. The same treatment applies as for non FS sector companies.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) The applicable accounting practice does not allow banks to use discretion to understate or overstate the book value of capital. 2) The tax treatment is the same for both subsidiaries and branches of non-domestic banks, i.e. there is no difference in treatment.

Bulgaria	
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	To the best of our knowledge, there are no practices adopted that differ from legal provisions as far as taxation is concerned. The banking sector in Bulgaria is strictly regulated, henceno deviances from the legislative framework exist.

Cyprus	
A. General tax regime applicable to banks	
General comments	There are discussions ongoing at parliament level in respect of additional taxes/levies that could be imposed to banks. However, as the questionnaire refers to legislation until January 2011, and as such legislation has not yet been enacted, we have not included any comments in this respect.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The standard tax rate of 10% on the taxable profits of the company is applicable to the banks in the same way as to other companies. There are no local taxes in Cyprus levied on the same type of income as the corporate income tax. There are local taxes applicable for banks as for all companies but as they are not applicable on corporate income they should be regarded to be outside the scope of this analysis. 2) No. 3) The corporate tax base is computed in the same manner as with other companies in other sectors 4) There is no turnover tax on gross interest.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements?	1) There is no specific tax relief available for banks. 2) There are no CFC or Thin Cap rules in the Cyprus tax legislation. 3) No. 4) The applicable legislation is the same for banks as for all other companies. Profits of permanent establishments of Cyprus companies located abroad may be exempt from Cyprus income tax subject to certain conditions (if these exemption criteria are not fulfilled, the profits are taxable in the same manner

Cyprus	
4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	as the remaining profits of the company, subject to double tax relief where applicable).
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Same treatment of banks as for companies in other sectors: Under circumstances, interest received by a Cyprus tax resident is subject to a 10% Special Defence Contribution (SDC). Under certain circumstances, the payer of such interest has an obligation to withhold at source any relevant SDC and remit it to the authorities. Banks are considered to be subject to such withholding requirements. Thus, interest paid by banks to Cyprus tax resident individuals and bank deposit interest paid to Cyprus tax resident companies is in general subject to withholding of SDC by the banks and paid to the authorities. Dividends paid to Cyprus tax resident individuals are subject to a 15% SDC. As for all other companies, when the bank pays such dividend it has an obligation to withhold such tax and pay it to the authorities. Companies tax resident in Cyprus (including banks) which do not distribute 70% of their profits after tax, as defined by the SDC legislation, during the two years after the end of the year of assessment to which the profits refer, will be deemed to have distributed this amount as a dividend. The DC at 15% will be payable on such deemed dividend to the extent that the shareholders (individuals and companies) at the end of the period of two years, from the end of the year of assessment to which the profits refer are Cyprus tax residents. The amount of this deemed dividend distribution is reduced by any actual dividend paid out of the profits of the relevant year at

Cyprus	
	any time within the two years. 2) Same treatment of banks as for companies in other sectors: Interest received accruing from ordinary (or closely related to its ordinary activities) of the taxpayer is considered as "active interest". Otherwise it is considered as passive interest. Active interest is taxed under corporation tax at the rate of 10%, after deduction of expenses wholly and exclusively incurred for the generation of the income. Passive interest is subject to Special Contribution for Defence (SDC) at the rate of 10% on the gross interest. SDC of 10% may be applicable under circumstances on interest payments to Cyprus tax resident companies and individuals. The banks have an obligation to withhold such SDC in respect of interest payable to Cyprus tax residents (in the event that the interest paid is subject to SDC). The legislation is the same as for all companies. However, according to a circular issued by the tax authorities, it is considered that all of the bank's interest income arises from its ordinary activities, and hence it is considered as active interest. Dividends received **from a Cyprus tax resident company** are exempt from income tax and SDC. Dividends received **from a non-Cyprus tax resident company** are exempt from income tax. They are also exempt from SDC provided that **either:**

Cyprus	
	▪ the dividend paying company engages directly or indirectly at least 50% in activities which emanate from non investment income (i.e. active income) **or** ▪ the foreign tax burden on the income of the company paying the dividend is not substantially lower than the tax burden of a company resident in Cyprus (taken to be not lower than 5%). Otherwise it will be subject to a, SDC at 15%. Credit may be available for any foreign tax that has been suffered on the same income against SDC (as explained earlier in the appendix). A tax credit is also available for underlying tax for dividends either from companies tax resident in EU Member States or where the double tax treaty provides so. 3) There is no WHT in Cyprus - except for dividends paid to individual Cyprus tax residents only and deemed distributions (refer to A.3.1 above). There is no withholding tax on dividends paid by Cyprus tax resident entities (including banks) to non residents. In addition there is no withholding tax on dividends payable to companies tax resident in Cyprus. There is a 15% Special Defence Contribution (SDC) payable for dividends received by individuals tax resident in Cyprus. As for all companies tax resident in Cyprus, if a bank resident in Cyprus pays dividends to Cyprus tax resident individuals, it has an obligation to withhold and pay this tax to the authorities. 4) Same treatment of banks as for companies in other sectors: In principle, interest income of banks resulting from advances or interest yielding securities is taxed on an accruals basis. 5) This is not applicable. There is no withholding tax on interest paid by

Cyprus	
	Cyprus tax resident entities (including banks) to non residents.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Same treatment of banks as for companies in other sectors: If the fixed assets are used by the business, they could be eligible to a "Wear and Tear" allowance. Upon disposal, there is a balancing addition (taxed at 10%) at an amount equal to: the lower of [a) initial cost and b) proceeds] - tax written down value. If the amount is negative, then a balancing deduction is available. If the fixed asset is not eligible for "Wear and Tear" allowances, then a gain is not taxable and aloss is not deductible.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	Same treatment of banks as for companies in other sectors: There is no specific provision in the legislation in relation to the taxation of a discount on the purchase of interest yielding assets. In general, the discount effect (if it is considered to be a discount due to market conditions as opposed to a discount due to circumstances that may cause the discount to be perceived as being of a capital nature) is expected to be considered to be released over the period that the asset is held and taxed as interest. Interest income generated from such assets is taxable (see above on taxation of interest income). Gains or losses on trading assets are in general respectively taxable/deductible unless the trading assets are qualifying "titles" in which case any gain is exempt (and as per the interpretation of the authorities any loss not deductible). Qualifying titles include shares, bonds, debentures, founder's shares other

Cyprus	
	corporate titles and rights thereon. As per the recent circular issued by the authorities the list of titles also includes: preference shares, short positions, swaps, GDRs, ADRs, index participations, futures and forwards on titles units in open ended or close ended collective investment schemes (Investment Funds, Investment Trusts, Unit Trusts, Real Estate Investment Trusts, International Collective Investment Schemes, Undertakings for Collective Investments in Transferable Securities ….).participations in companies andRights of claim on bonds and debentures.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	Same treatment of banks as for companies in other sectors: Bad or doubtful debts are tax deductible provided that the Commissioner is satisfied that the Bank has taken all satisfactory measures for the collection of the loan (there is no specific provision in the legislation of what "satisfactory" measures encloses and thus it depends on the specifics of each case, i.e. certain cases the Commissioner may request that a legal action is taken against the debtor in order to grant the deduction). (i) No (ii) General provisions are not deductible. (iii) Not applicable, general provisions are not deductible. (iv) Specific provisions are not completely discretionary. The IFRS results of a company are the basis on which tax adjustments are made, the basis of the provision is in general expected to be satisfactory for IFRS. Whether or not the said provision is deductible, refer to (1) above. (v) Specific provisions are deductible subject to (1) above. (vi) No limitations are applicable, but the Commissioner may consider

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	whether specific provisions are excessive and seek to disallow a part of or the entire provision.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Same treatment of banks as for companies in other sectors: Based on the law, any expenses incurred wholly and exclusively for the generation of the income of a company are tax deductible. Real expenses/costs related to a stock option plan are tax deductible. Certain principles in relation to the deductibility of such expenses are set out in a relevant tax circular.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Same treatment of banks as for companies in other sectors.Banks (as all companies that are tax resident in Cyprus) are required to prepare financial statements in accordance with IFRS as adopted by the European Union and the requirements of the Cyprus Companies Law. Therefore, a discretion or flexibility needs to be applicable within IFRS as adopted by the EU framework. 2) On the understanding that the branches form permanent establishments, there are no differences in applicable provisions..
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	Same treatment of banks as for companies in other sectors: Based on the law, any gains on titles are not taxable. The legislation is silent in relation to losses, however the practice followed by the tax authorities is that they are not deductible.

Czech Republic	
A. General tax regime applicable to banks	
General comments	There is nospecial bank levy or any Financial Activities Tax levied on banks in the Czech Republic. Till this moment, there are no proposals in this respect and we are not aware of any Government intentions in this area.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1. Banks are, like other entities, subject to a Czech corporate income tax at the general tax rate of 19%. No local or other taxes are imposed on banks activities, as is also the case for other sectors of activities. 2. No. 3. The rules for computing the tax base are generally the same as for other companies. Nevertheless, certain differences may occur (e.g., thin capitalisation rules, Banking Reserves and Provisions). 4. No.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) There are specific rules for thin capitalisation applied for banks' interest cost. The thin cap rules are not designed as an anti-avoidance measure, but they are applied as a general measure against tax base erosion. Interest and other financial costs related to the credits and loans received from a related party which exceed six times the equity of the bank are considered to be tax non-deductible expenses. Under Czech tax rules there are no special thin capitalisation rules for taxpayers with preferential tax regimes. If interest paid to a related party in the non-EEA country exceeds six times the equity of the bank, those interests are for Czech tax purposes reclassified as dividends, unless the relevant double tax treaty does not "switch" the classification back to "interest". 2) No. The thin capitalisation rules applicable for banks and insurance companies

Czech Republic	
	provide for a debt/equity ratio of 6:1, whereas for other companies this ratio is set at i 4:1. 3) No. 4) No. There could however be certain differences between taxation of subsidiaries and branches stemming from legal characteristics of branches. There are also difficulties for branches with attribution of the equity for thin capitalisation purposes.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Tax treatment of paid dividends and interest is the same as for other companies.There is withholding tax on outbound dividends and interest, unless there is an exemption under the EU Directives or under the applicable double tax treaty. 2) Tax treatment of received dividends and interest is the same as for other companies. This is a self-assessed tax in an annual corporate income tax declaration (inbound dividends from abroad are taxed in a separate tax base at 15% (credit available only from treaty countries), while inbound interest is taxed in the standard corporate tax base. Inbound dividends from EU countries and also from third countries are under certain conditions similar to those defined by the Parent-Subsidiary Directive, exempt from corporate taxation. In case of inbound interest, there is no tax exemption possible (Interest-Royalties Directive will be applied only for withholding tax in cases of outbound interest under the conditions set by the Directive). 3) Dividends paid to residents and also to non-residents tax payers are subject to a 15% final withholding tax unless there is a participation exemption applicable under the Parent-Subsidiary Directive or the rate is decreased based on the double tax treaty. 4) Interest income of non-residents may be considered taxable income in the Czech Republic based on the cash-flow (instead of accrual basis as in case of tax residents – accounting (and tax) treatment is close to IAS 39).

Czech Republic	
	5) Yes, a WHT is due when it is paid to individuals or foreign corporations (a tax treaty, if applicable, can alter the tax treatment stipulated by Czech tax law). A Czech permanent establishment is responsible for the correct application of the WHT on interest paid abroad. In case of a Head-Office situated in the Czech Republic, the foreign branch of the Czech bank is responsible for the correct withholding.However, in case the WHT has not been properly withheld, this will have a a direct effect in the books of the Head-Office as the Head-Office and the foreign branch are one entity.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Under the Czech Income Taxes Act, gains on fixed assets enter the general tax base for tax residents (banks and also the other corporate tax payers). For non-residents, income from the sale of assets is considered to be Czech-source income subject to corporate income tax. Tax non-residents are obliged to file a corporate income tax return and tax the gain at the 19% standard corporate income tax rate. The Czech tax rules may be overruled by the applicable double tax treaty. Losses on fixed assets may be claimed in the tax return towards other income coming from the Czech Republic during the taxable period.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1. Taxpayers keeping Czech double-entry accounting records follow the accounting rules and they are taxed in the corporate tax base. 2. Changes in the fair value of assets held for trading purposes are recognised in the P&L account. They are also relevant for tax purposes (taxed in the corporate tax base).
F. Tax treatment of bad or doubtful debts on advances and loans	
	(i), (iii) Under the Czech Income Taxes Act and the Act on Reserves, for the purposes of computing the income tax base, there are special tax rules for creation of bank provisions against non-statute-barred receivables from credits. General provisions are

Czech Republic	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	not allowed. The balance of provisions should be allocated to particular receivables. (ii), (vi) Provisions created under the accounting rules are not tax deductible, unless they meet the below criteria. There are special rules defined for banks. In a taxable period, the total amount of creation of provisions may not exceed 2% of the average balance sheet value of non-statute-barred receivables relating to principal and interest from credits. For the purposes of creating provisions , a receivable from a credit means a receivable relating to principal and interest if ▪ it arose from credit granted by a bank to a person that is not a bank, or ▪ receivable from fulfilment of a bank guarantee which concerns a person from another EU Member State and the contract was concluded as a credit contract or a contract on bank guarantee under the EU state legislation ▪ provisions have to be individualised, i.e. assigned to a particular debt (but the percentage of assigned provision covering a receivable in the given year may be up to 100% of the receivable (loan+ interest)) (iv) Yes – there is an option to claim a certain amount of accounted provisions as tax-deductible. If the criteria for creation of tax provisions are not met or the bank decides not to claim provisions for tax purposes, then the provisions are not-deductible (at release not-taxable). (v) Tax provisions can only be createdas specific provisions to a particular receivable.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Employee stock options are considered to be employment (taxable) income for particular employees and a deductible (payroll) expense. The income is determined upon the exercise of an option as the difference between the fair market value of

Czech Republic	
	granted securities and their strike price.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1. Czech GAAP for banks is very similar to IFRS. Judgement is needed to prepare proper financial statements, but the framework is not considered more susceptible to capital manipulation than IFRS. 2. No, as long as the bank is an accounting entity under the Czech accounting rules.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	Not aware of any.

Denmark	
A. General tax regime applicable to banks	
General comments	No bank levy applicable and no Financial Activities Tax. There are no pending proposals in this respect. Please note that Danish banks are required to pay a payroll tax. The tax is calculated as 10,5% of the payroll total. The payroll tax is deductible in the corporate income tax. Payroll tax is in general applicable for all entities performing economic activity not subject to VAT. However, some exceptions may apply i.e. social aid, artistic activity, sale of real estate. There are four different methods for calculating the payroll tax depending on the nature of the VAT exempt activity, where one specific method (10,5 % of the total payroll) is applied in the financial sector. The tax is paid by the bank/financial institution and is due each month on the 15th day following the month.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The CIT rate of 25% applies to the financial sector and non-financial sector. Denmark does not apply local taxes. 2) No 3) The computation of the tax base does generally not differ from other sectors. 4) No
B. Specific tax regime applicable to banks	
	1) No.

Denmark	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	2) CFC applies to both financial and non-financial sectors. However banks can be granted dispensation from the Danish tax authorities to not include CFC-income from Danish and foreign subsidiaries and branches in the Danish income. A permit is needed from the Danish Tax Assessment Committee. In order to qualify the following conditions must be met: It must concerne subsidiary of company with a license to be a financial company and subject to public supervision; A substantial part of the income must arise from customers (not affiliated) in the company's country of residence; The subsidiary's capital base must not exceed what is usual to operate the subsidiary; Any WHT dividends must be lowered or exempted due to the interest/royalty directive or a double tax treaty. The dispensation is applicable for financial companies (which comply with the above requirements) which are not regarded as a controlled financial company and as a result the company should not be taxed in Denmark as a result of the Danish CFC rules. Banks are in general not comprised by the Danish deductibility limitation of interest expense rules. The Danish interest deduction limitation rules are rather complex. However, on an overall basis the rules were introduced in order to prevent companies (in particular companies/Groups controlled by private equity funds) from avoiding paying taxes in Denmark due to large interest payments on loans. For the financial sector interest income and payments are in general not regarded as financial income/expenses under the Danish interest deduction limitation, but merely as "trading" income. As a result companies in the financial sector are in general not comprised by the rules.

Denmark	
	3) No. 4) No, see above under item 2
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1: No special rules: Interest is in general deductible (however limitation of deductibility may arise due to Danish deductibility limitation of interest expense rules). Dividends paid are notdeductible. 2: No special rules: Interest received is in general taxed. Dividend received from subsidiaries (e.g. ownership of at least 10% for companies within EU) are nottaxable, while dividends received from portfolio-shares (<10%) are taxed. 3: WHT is levied on dividends which do not qualify for an exemption under the Parent-Subsidiary Directive. The WHT may be reduced if recipient qualifies for relief under a DTT. 4: Mark-to-market principle 5: In general there are no WHT on interest paid to third-party banks. WHT is not levied on interest payments to third parties. WHT can be levied on interest payments on controlled debt from affiliated companies (subject to exemption or reduction if receiving company qualify under DTT or directive).
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	1) No special rules. Gains and losses are in general respectively taxable/deductible. However some losses may only be utilized against gains from a similar source, e.g. losses due to sale of real estate can only be utilized against gains from sale of real estate.

Denmark	
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) We assume that government bills are to be understood as government bonds. Based on this assumption; Denmark does not grant discounts on government bonds, trade bills or other instruments. If a Danish company invests in government bills issued by other EU countries the bill would be treated as claim against the EU country. From a Danish tax point a claim held by a company in the financial sector would be taxable according to a mark-to-market principle. However, the tax may be reduced or exempted according to a DTT (we have no knowledge of any DTT with EU countries which exempt or reduce tax on interest on foreign government bonds) 2) Generally, the mark-to-market principle would apply. Gains are taxable and losses deductible
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	1) Banks are allowed to treat provisions for tax purposes in accordance with the Company's current accounting principles. In general tax treatment follows accounting treatment. However, the Danish tax authorities may not accept that the provision as being deductible if the loss on the underlying asset would not be deductible according to Danish tax law. (i) No (ii) Yes. (iii) Only if losses would not be tax deductible at realisation (iv) No (v) No

Denmark	
	(vi) Same as iii)
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	For stock options plans with an element of tax payments postponement and beneficial taxation for the employees, the stock option plan would in general not be tax deductible for the Company. The same treatment applies to FS- and non-FS companies. However, FS companies that have qualified to receive financial aid (act no. 67 of 3 February 2009) from the government following the financial crisis can only deduct 50% of wage to company executives. Companies can choose which stock options plans to use (of which some are tax deductible).
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Yes, interpretation relating to impairment is possible which has a direct impact on the underlying balance sheet assets. Impairments related to loans are in general treated identical from an accounting and a tax perspective. 2) No
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	We have no knowledge or experience with actual practices differing from legal provisions in Denmark.

Estonia	
A. General tax regime applicable to banks	
General comments	There is no bank levy applicable in Estonia, no Financial Activities Tax and no (pending) proposals in this respect
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) Under the existing Estonian corporate tax regime, any undistributed profits are exempt from corporate taxation, until the company makes an actual or hidden profit distributions. Actual profit distributions include dividends, share buy-backs, capital reductions and liquidation proceeds. Hidden profit distributions include transfer pricing adjustments, expenses and payments that do not have a business purpose, fringe benefits, gifts, donations and business entertainment expenses (exceeding established limits). Thus, the 21% corporate tax is deferred until the distribution of profits. There is no local corporate tax or other surcharge on corporate profits. 2) There is no special tax rate for banks. 3) There are no specific tax rules for banks. For all sectors, distributable profits are determined by financial statements drawn up in accordance with IAS/IFRS and there is no adjustment of accounting profits for tax purposes. 4) There are no turnover taxes on gross interest and other income of banks, as Estonia follows the principles of EU VAT Directive, under which the financial services are generally VAT exempt supply.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial	1) There are no specific corporate tax relief rules for specific items of income, such as interest income. 2) There are no CFC or thin capitalization rules for companies. Some specific anti-avoidance rules are different to the banks. For example, the list of payments which are deemed not to be related to business for other sectors (but

Estonia	
sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	not to banks) includes the following: ▪ acquisition of property not related to business; ▪ acquisition of securities issued by a legal person located in a low-tax territory, unless such securities meet the requirements specified in subsection 257 (1) of the Investment Funds Act; ▪ acquisition of a holding in a legal person located in a low-tax territory; ▪ payment of a fine for delay or a contractual penalty, or extra-judicial compensation for damage, to a legal person located in a low-tax territory; ▪ grant of a loan or making of an advance payment to a legal person located in a low- tax territory or acquisition of a right of claim against a legal person located in a low-tax territory in any other manner. The above payments are subject to monthly 21/79 corporate tax by companies of other sectors, but not by resident credit institutions, to which a following separate set of rules applies (Article 52 (3) of the Income Tax Act). Resident credit institutions pay 21/79 monthly income tax on the following payments and losses, unless income tax has been withheld on such payments and losses or 21/79 income tax has been paid according to provisions of Articles 48-51 of the Income Tax Act: ▪ acquisition of property not related to business; ▪ acquisition of securities issued by a legal person located in a low-tax territory, unless such securities meet the requirements specified in subsection 257 (1) of the Investment Funds Act; ▪ payment of a fine for delay or a contractual penalty, or extra-judicial

Estonia	
	compensation for damage, to a legal person located in a low-tax territory, unless such payments are made to a credit or financial institution which according to the law of its country of location meets the requirements for similar institutions equal to Estonian credit or financial institutions; ▪ losses incurred by a credit institution when it transfers a right of claim or waives the collection of a right of claim (including loans granted and advance payments made) acquired against a legal person located in a low-tax territory. 3) There are no provisions, under which some types of financial companies could be excluded from double-tax agreements. 4) There are no specific tax rules for subsidiaries and branches of banks. For banks, distributable profits are determined by financial statements drawn up in accordance with IAS/IFRS and there is no adjustment of accounting profits for tax purposes.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of	1) Interest paid by all companies is generally "tax deductible", taking into account that in the absence of thin capitalization rules and with the exemption for undistributed profits there is no adjustment of corporate profits for tax purposes (= distributable profits are determined by financial statements drawn up in accordance with Estonian GAAP or IAS/IFRS and there is no adjustment of accounting profits for tax purposes.) The Estonian source taxable income of the non-resident does not include arm's length interest, regardless of the type of the underlying financial instrument. Under the domestic law the arm's-length interest paid to non-residents is not subject to any WHT.

Estonia	
the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	However, the excessive interest which significantly exceeds the arm's length interest at the time of granting the loan and the repayment of the loan is deemed to be Estonian source taxable income of the non-resident. In case of non-arm's length interest, the difference between the excessive and the arm's length interest is subject to a 21% WHT at source. Profits distributed as dividends trigger a deferred corporate income tax charge amounting to 21/79 of the net amount of the profit distribution. This is a grossed-up rate and provides the same result as if a 21% tax had been imposed on the gross income. For example, if in 2011 the company has profits available 100, then it can distribute as dividends 79 to its shareholder and must pay 21 as a monthly corporate tax upon distribution. This tax is regarded as a deferred corporate tax and not a withholding tax, so the tax rate of this distribution tax is not affected by double tax treaties. The corporate income tax liability associated with the distribution of dividends is accounted for as an expense at the time the dividends are declared, regardless of when the profits were generated or distributed. 2) Interest received is included in the corporate profits of the company, but such profits (like other types of profits and gains) are not subject to any corporate tax, until the company makes any distributions. Dividends received are included in the corporate profits of the company, but such profits (like other types of profits and gains) are not subject to any corporate tax, until the company makes any distributions. However, under the participation exemption rule, dividends distributed by companies are exempt from 21/79 corporate income tax if the distributions are paid out of: ▪ dividends received from Estonian, EU, European Economic Area (EEA)

Estonia	
	and Swiss tax resident companies (except tax haven companies) in which the Estonian company has at least a 10% shareholding; ▪ profits attributable to a permanent establishment (PE) in EU, EEA or Switzerland; ▪ dividends received from all other foreign companies in which the Estonian company (except tax haven companies) has at least a 10% shareholding, provided that either the underlying profits have been subject to foreign tax or if foreign income tax was withheld from dividends received; or ▪ profits attributable to a foreign PE in all other countries provided that such profits have been subject to tax in the country of the PE. Estonian participation exemption rules do not include any trading/fixed asset test. The main criteria is 10% participation in the shares or voting power of the other EU, Swiss or EEA company. 3) Under the Estonian domestic law, there is no WHT on dividend distributions to non-resident shareholders (regardless of their participation level in the Estonian company). There is also no WHT on dividends paid to tax haven entities. 4) The interest on advances and all securities must be accounted in accordance with IAS/IFRS. There are no specific rules on the tax treatment of such items. 5) Under the domestic law, the Estonian source taxable income of the non-resident does not include arm's length interest. However, the excessive interest which significantly exceeds the arm's length interest at the time of granting the loan and at the time of the payment of the interest is deemed to be Estonian source taxable income of the non-resident. Repayment of the loan is not subject to any WHT. This criteria applies to the time when arm's-length nature

Estonia	
	of the interest is determined. In case of non-arm's length interest, the difference between the excessive and the arm's length interest is subject to 21% withholding tax at source. Under the domestic law, only the excessive interest is subject to 21% WHT and there is no WHT on normal arm's-length interest paid to non-residents. Under the domestic law, dividends paid to non-residents and residents are not subject to any WHT. Thus, the WHT is due for excessive part of interest payments, including the payments paid to third parties by the head office situated in Estonia or by the Estonian branch of the foreign bank. There will be no WHT by the head office, if its foreign branch (situated abroad) pays non-arm's length interest to a third party.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Any gains are included in the corporate profits of the company, but these are not subject to the corporate tax, until the company makes any distribution of profits. There is no adjustment of accounting profits for net operating losses for tax purposes. Distributable profits are determined based on financial statements drawn up in accordance with IAS/IFRS. There are no specific rules on the tax treatment of gains and losses on fixed assets.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) The financial practices/instruments must be accounted in accordance with IAS/IFRS. There are no specific rules on the tax treatment of such items. 2) The assets held for trading purposes must be accounted in accordance with IAS/IFRS. There are no specific rules on the tax treatment of such items.

Estonia	
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	The bad or doubtful debts on advances and loans must be accounted in accordance with IAS/IFRS. There are no specific rules on the tax treatment of such items. Thus, general and specific provisions are tax exempt – which is logic since no taxation unless distribution (whatever the amount and the justification).
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	As there is no annual taxation of net corporate profits, there is no "tax deduction" in its classical meaning. Stock option plans qualifying for an exemption from fringe benefit taxation upon the exercise at the level of the employer are "deductible" (i.e. not subject to monthly taxation). As described above, notwithstanding the fact that undistributed corporate profits are tax exempt in Estonia, certain payments and expenses are deemed to be hidden profit distributions, which are triggering monthly taxation. Non-qualifying stock option plans are subject to monthly fringe benefit taxation at the level of the local employer, whereas the total fringe benefit tax burden for the local employer would be approximately 68% of the value of the benefit received by employees. There is no corporate taxation, if the company will not make any profit distributions in form of dividends or hidden profit distributions during these 5 years. Such deferral of corporate taxation is not limited in time. The monthly income tax is triggered at the moment of making the profit distributions. It remains unclear for us whether at least 3-year vesting period for the exemption of fringe benefit taxes on the level of the local employer in itself

Estonia	
	can be considered as a condition for deductibility in the context of this section.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) No. 2) There are no differences in the provisions applicable to subsidiaries and branches of non-domestic banks.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	Under the information available, for all the above questions the actual practices should not differ from legal provisions.

Finland	
A. General tax regime applicable to banks	
General comments	In Finland there is no bank levy or any Financial Activities Tax. There are no pending proposals in this respect, either.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1)The corporate income tax rate for banks does not differ from the general corporate income tax rate (26%).There are no local taxes in Finland 2) No special tax rates are available for banks. 3) Generally not but there are a few exceptions with regard to e.g.: ▪ group contribution regime (which is not applicable to banks). Group contribution regime enables Finnish resident group companies to even out their taxable profits and losses. A group contribution is tax deductible expense for the payer and taxable income for the recipient company for the tax year during which is has been given and received provided that certain specific requirements are met. Group contribution regime is not applicable to financial and credit institutions. The non-availability of the group contribution regime is disadvantageous for the financial and credit institutions. ▪ tax deductibility of general doubtful debt provision (which is applicable only to depository banks and credit institutions); ▪ taxation of unrealized gains and losses on certain financial instruments and investments recognized as income/expense in the accounts of banks and finance institutions according to Sec. 151 of the Law on Finance Institutions, Banks and Finance institution or in accordance with the international accounting standards meant in the Article 1 of Chapter 7a of the of the Finnish Bookkeeping Act, and ▪ tax deductibility of statutory payments e.g. to the Deposit Insurance Fund defined in the Law on Credit Institutions or the Investors' Compensation Fund

Finland	
	defined in the Law on Finance Institutions, Banks and Finance institutions. Apart from items a) and d), these rules are described in more detail below). 4) No differences in the regulations compared to other companies. There are no specific turnover taxes applicable to banks.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) No specific tax relief rules are applicable to banks. 2) There are no specific anti-avoidance rules or rules to avoid offshoring of profits for banks. 3) Generally no. Majority of double tax treaties concluded by Finland are based on the OECD Model Convention. 4) In principle there are no specific rules for the taxation of subsidiaries or branches of banks.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)?	1) There are no differences with respect to corporate income tax treatment of dividends or interest paid by banks compared to other companies. We confirm that interests paid by banks are tax deductible and dividends paid by banks are non-deductible according to normal rules. Taxation of dividends received by banks from shares belonging to investment assets differs from the tax treatment of other companies. Please refer to our answer for

Finland	
4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	question A.3.2. **2)Interest income** There are no differences as regards of taxation of interest received compared to other companies. Interest received by banks is taxable. **Dividends received** Taxation of dividends received by banks slightly differ from the tax treatment of other companies e.g. in case the dividends are received from shares belonging to investment assets of the bank as only financial, insurance and pension institutions may have investment assets. Investment assets comprise e.g. securities and participations if they have the nature of a long-term investment or investment security. Dividends from shares belonging to investment assets are 75% taxable income instead of being tax-exempt. This was a compromise between alternative legislative solutions. However, if the recipient company holds directly at least 10% of the capital of a non-Finnish resident distributing company and the distributing company is mentioned in the EU Parent-Subsidiary Directive, the dividend is tax-exempt. Further, dividends received by a cooperative bank from a commercial bank operating as a central financial institution of the cooperative banks is tax-exempt income 3) There are no differences in WHT treatment of dividends received by banks compared to other companies. WHT levied in accordance with an applicable tax treaty is normally credited against the corporate income tax payable in Finland over the same period (unless the income is exempted according to the treaty/domestic tax legislation) in accordance with the Finnish Act on Elimination of International Double Taxation. The amount of tax credited is limited to the amount of tax payable

Finland	
	in Finland. The maximum credit is calculated based on source of income (business income, other income or agricultural income). If not all the tax paid in a foreign state can be credited (for example if the company is not in a tax paying position due to a loss or deduction of carry forward tax losses) the amount of tax which remains uncredited is deducted in the following five tax years from the tax on income derived from the same source of income. 4) Generally interest income (including interest on advances and on securities) is allocable on an accrual basis. There are no differences compared to other companies. 5) Pursuant to Finnish domestic law Finnish source interest paid by Finnish resident depositary bank or Finnish branch of a foreign financial institution to a Finnish resident individual or decedent's estate on bank account deposits and from certain bonds offered to the public for subscription is subject to interest WHT at a rate of 28%. Interest is regarded as Finnish source if the debtor is e.g. a Finnish resident corporate body. Generally, no WHT is levied on interest paid to non-residents unless the debt is regarded equivalent to equity. As a foreign branch of a Finnish resident bank is legally part of the bank, it could be argued that interest paid by a foreign branch of a Finnish resident depository bank on qualified bank account deposits and bonds to Finnish resident individuals or decedent's estates would be subject to the Finnish interest WHT pursuant to domestic tax rules. If interest is paid to a non Finnish third party, it would not be subject to the Finnish interest WHT pursuant to domestic tax rules.

Finland	
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Generally, there are no differences compared to the tax treatment of other companies. Please note, however, that only cooperative banks, savings-banks and banks established as limited liability companies can be entitled to capital gains tax-exemption on fixed assets shares (belonging to business assets). Capital gains from selling fixed asset shares belonging to business source income are tax exempt, if the following conditions are met: 1) The shares have been continuously owned for at least one year in a period of time that has ended not more than one year before the sale, and 2) The ownership share in the company whose shares are sold is at least 10 %, and 3) The company whose shares are sold is a resident in Finland or another EU Member State, or in a tax treaty country, and 4) The company whose shares are sold is not a real estate company, or a company, whose activities consist mainly of owning and holding real estates, 5) The company selling the shares is not a company carrying out private equity activities (as defined by BITA). Rules concerning tax exempt capital gains are applicable to limited liability companies, cooperative associations, savings-banks, and banks established as limited liability companies and mutual insurance companies provided that the above-mentioned criteria are met. Please note that there are, however, some exceptions to the above main rule. If the conditions set above are not met the gain is taxable income as normal business income (unless regarded as income from other source).

Finland	
E. Tax treatment of some financial practices/instruments	
2. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 3. How are assets held for trading purposes treated for tax purposes?	1) No differences with regard to tax treatment of these instruments compared to other companies. 2) Generally, the tax treatment of assets held for trading purposes is similar for banks and other companies. According to the Government Proposal HE 176/2008 concerning the relevant tax provisions, financial instrument is regarded as being held for trading purposes, if it is not subject to hedge accounting effectively meeting the conditions set out in IAS 39. In addition to the above, unrealized gains and losses on ▪ financial instruments valued at fair market value on the basis of fair market value option and ▪ financial instruments that take part to fair market value hedging which are recognized as income/expense in the accounts of banks and finance institutions according to Sec. 151 of the Law on Finance Institutions, Banks and finance institutions or in accordance with the international accounting standards meant in the Article 1 of Chapter 7a of the of the Finnish Bookkeeping Act, are treated similarly for income tax purposes (i.e. unrealized appreciation gains are taxable and respectively, unrealized decrease in value is tax-deductible).
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions?	(i)No minimum amount is required for the general doubtful debt provision. (ii) Only depository banks and other credit institutions are entitled to make a tax-deductible doubtful debt provision annually. It is required e.g. that the provision is

Finland	
(ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	recognized as expense in the accounts of the bank. (iii) The doubtful debt provision cannot exceed 0.6% of the amount of total receivables outstanding at the end of the tax year. However, the amount of the annual provision together with the provisions made in previous years cannot exceed 5% of the amount of the outstanding receivables as of the end of the tax year. If the provision exceeds the maximum amount in any one year, the excess is regarded as chargeable income for that year. If a depository bank has previously transferred the bad debt provision to its reserve fund tax neutrally, the transferred amount will also be taken into account when calculating the maximum amount for the provision. Reserve fund is a specific reserve of a limited liability company. Reserve fund is part of the restricted equity of the company Further, if more receivables are transferred to another group company than what is left for the company that has transferred the provision to its reserve fund, the amount of the provision transferred to reserve fund is divided between the group companies in proportion of the receivables when calculating the maximum amount for the provision. Cash deposits to banks are not considered as receivables. (iv) There are no specific tax provisions on bad or doubtful debts. However, e.g. loan specific provisions can in certain cases be included in the general provision; see below (v). Further, banks are entitled to deduct a permanent/final loss in value of a receivable (other than a trade receivable) if the receivable has also been written off in the accounts The tax deductible general provision is calculated after the permanent/final loss in value of receivables has been deducted. (Please note that writedowns on intra-group receivables are not deductible as a main rule). Please further note that the final credit loss deduction is based on a tax rule

Finland	
	applicable to all companies (hence in this respect the taxation of banks does not differ from the taxation of other companies). (v) Even if no specific tax provisions on bad or doubtful debts exist, pursuant to Finnish case law e.g. loan/client etc. specific provisions deducted for accounting purposes has been accepted as tax deductible provided that the amount of such provision does not exceed the limits of the general doubtful debt provision. the limits of the general doubtful debt provision are those referred to under (iii).
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	There are no differences with regard to tax treatment of other companies. <u>A limited liability company grants its own shares to its employees</u> Generally, salaries and salary related costs are deductible in taxation in Finland. Finland has implemented new rules related to deductibility of costs regarding employee share plans which have been effective as of 1 January 2009. These rules apply to situations where a company gives its shares to its employees. According to the rules, costs related to shares that have been given to an employee based on employment are deductible in taxation if the company has acquired the shares in a public exchange (e.g. OMX) in Finland or abroad. The maximum amount of deduction is the fair market value of the shares at the time of subscription or assignment less the subscription price. In other words, it is required that there is actual cost. If only newly issued shares are used, the fair market value of the shares cannot be regarded as cost for the company. These new rules are not applicable to share plans where another company's (e.g.foreign parent company's) shares are offered (see below). <u>A group company's shares are granted to the employees of a Finnish resident limited liability company (deductibility of a recharge)</u> Based on Finnish published case law, recharged incentive plan related costs (e.g.

Finland	
	where foreign parent/group company's shares are given/offered to the employees of a Finnish group company) have been accepted as deductible in the Finnish group company's taxation where the amount of recharge has corresponded the actual costs that the group/parent company had faced and where the recharged costs have not exceeded the fair market value of the shares at the time of the delivery (to the employees). Please note, however, that based on the court practice the principles of the deductibility in relation to recharge of incentive plan costs/incentive shares are not fully developed.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Normal IFRS rules apply. 2) There are no differences in provisions applicable to subsidiaries and branches of non-Finnish banks.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	We are not aware that practises would differ from the legal provisions

France	
A. General tax regime applicable to banks	
General comments	There is a tax on systemic risks (see below I) applicable in France. To the best of our knowledge, there is no other pending proposal, the tax on systemic risks being the most recent tax enacted (i.e. in the Financial Bill for year 2011).
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1+2. There is no tax rate specifically applicable to banks. CIT is 33.33% plus a 3.3% social tax computed on the CIT when exceeding EUR 763,000. There are local taxes (e.g. the CET/CVAE - see our email sent on 11 April 2011 and our comments related to the determination of the value added for CVAE purposes in point A.4 below) but they are not part of what we call the CIT and are not specific to banks. As a comparison, France differs from certain countries such as Luxembourg or Germany that have both a CIT and a Municipal Business Tax/Trade Tax that varies depending on the location where a company is set up. 3. The computation of a bank's taxable result will also differ from other classic companies as a result of the application of specific accounting rules proper to banks and financial establishments. <u>Specific tax rules :</u> <u>Short term investments:</u> According to article 38 *bis* A of the French Tax Code ("FTC"), listed stocks, receivables traded on a regulated market or instruments from the banking sector initially booked as "short term investments" (*"titres de transaction"*, i.e. assets purchased and sold for speculation purposes within a short timeframe - classically during the 6 months following their acquisition) are to be valuated at year end in application of the mark-to-market valuation principles. Capital gains

France	
	that may be crystallised further to this valuation are then subject to CIT. Same tax treatment applies in case of a sale of the asset or modification of its accounting status in the books of the bank (e.g. transfer from the "transaction asset" accounting item to the "placement asset" accounting item). Fixed income: Article 38 *bis* B of the FTC compels banks, that acquire fixed income (e.g. financial instruments, treasury bonds, tradable receivables generating a fixed income…) for a price differing from their face/reimbursement value, to reflect this difference (either a gain or a loss) within their taxable results. The difference in value will be spread from the date of acquisition until the date of effective reimbursement of the asset. When the reimbursement value of bonds (e.g. indexed bonds) or negotiable debts' premium (*"titre de créance négociable"*) is not determined at the time of the acquisition of / subscription to the said asset, the specific provision of article 238 *septies* E would apply. This article compels companies to compute their premium by reference to an actuarial interest rate and to spread over their premium when the expectable reimbursement value of the receivable exceeds 10% of its issuance value. Assets denominated in a foreign currency: According to article 38-4 of the FTC, financial assets (e.g. stocks, bonds, negotiable debts…) recorded in the bank's account in a foreign currency are subject to a valuation in Euro at year end. Forex (gains or losses) generated by such valuation are to be included in the annual tax result of the company. It should be mentioned that investment securities and long term shareholdings

France	
	financed with euro denominated resources are excluded from this valuation obligation. Derivatives: Specific rules apply whereby tax treatment is entirely in line with accounting rules. Financial instruments such as swap contracts must be categorized and their accounting/tax treatments will depend on their specific category. For some derivatives (i.e. interest rate derivatives and Foreign exchange derivatives) the mark-to-market valuation is to be applied at the closing of each financial year. As a result, latent capital gains on derivatives are taxable while latent losses are deductible. According to market practice and due to the absence of specific regulated market allowing the mark-to-market evaluation of certain derivatives (e.g. equity swap) a mark-to-model valuation developed by banks and financial establishments is authorised by the French Tax Authorities ("FTA"). Please refer to the Questionnaire "Taxation of Financial Instruments" for more details. 4. According to French tax law, a value added contribution ("*Cotisation sur la valeur ajoutée des enterprises* – "CVAE") is assessed on the value added of any French companies (i.e. financial or non financial companies) when their turnover exceeds EUR 152,500. The tax is computed by applying a progressive tax rate ranging between 0% and 1.5% (for turnovers not exceeding EUR 50 million, 1.5% otherwise) to the added value of the company. For credit establishments and assimilated companies, the computation of both the turnover and the added value is following specific provisions (e.g. 95% of dividends deriving from long term shareholding are not taken into account instead of a total exclusion). Classically, dividends and other accounting items of the financial result are not taken into account in computing the added value of a company for CVAE purposes. However, bank establishment and companies

France	
	managing financial instruments may receive significant amounts of dividend; as such income is more in line with their activity. The fact that 5% of the dividends are taken into account is thus more a way to add result to the added value basis rather than excluding some. Besides, please note that the dividend exclusion only applies to dividend deriving from specific shareholding booked under specific accounting items (those items being specific to bank and credit establishment), i.e.: - shareholding in related companies (*"parts dans les enterprises liées"*), and - long term shareholding (*"titres de participations"*) As a consequence, dividends deriving from other shares recorded in the accounts of the banks will still be taken into account for determining the added value. This is mainly linked to the accounting regulation and the way the bank intends to record a shareholding in its accounts. The rational in adding back 5% of the dividends in the added value computation instead of granting a complete exemption is a way to ensure the FTA would accept the deduction of financial charges that can be connected with the shareholdings generating the dividends. Should the entire amount of dividends be excluded, the FTA would have considered the charges connected with the shareholding as non deductible from the added value basis. For banks and financial establishments, the definition of the value added is the difference between the turnover of the establishment and specific accounting items. **The turnover** mainly includes the income deriving from bank activities and

France	
	other products of activities (*"produits divers d'exploitation"*) **save for**: ▪ 95% of dividend deriving from long term shareholding, and ▪ capital gains on disposal of long term assets (other than shareholding) recorded as "other product of activities", and ▪ reversal of special provisions, ▪ portions of capital grants, ▪ portions of banking operations made in common. The other items to be subtracted from the turnover are for example the banking charges linked to provisions on long term assets given in lease, some external services and some accounting items refer to as "various charges of activities" (*"charges diverses d'exploitation"*).
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1. Based on sole domestic legislation, there is no specific tax relief for interest income. 2. Same anti-avoidance rules apply to either a company or bank establishments. However, article 212 § II.2.2° of the FTC specifically exclude credit establishment (i.e. bank establishment having a regulated status) from the scope of the thin capitalisation rules. Same goes for French PE of foreign regulated credit establishments. The regulatory status of bank and credit establishment is indeed the reason.

France	
	For information purposes, it should be mentioned that article 238 *bis*-0 I of the FTC compels French companies to a tax consolidation of the result of defeasance entities located abroad. In essence, if the bank transfers assets or off balance sheet items (e.g. guarantees) to a foreign entity which purpose is to manage the assets/off balance sheet items for the benefit of the bank, income derived from such management shall be included in the taxable result of the bank. Though this provision of FTC is now generalised to any French company, it was originally drafted to prevent financial establishment from transferring their assets to other jurisdictions, hence avoiding French CIT on income deriving from the said assets managed abroad for their sole benefit. Finally article 209 B of the FTC compels French companies (credit establishment or not) to include in their taxable results the income generated by their subsidiaries, located in privileged tax countries, even if no effective distribution has been effectively made. 3. No 4 Generally speaking, same tax rules apply to banks' subsidiaries and PE According to FTA practice, the PE's level of equity is sometimes challenged when not in line with the solvability ratio of the foreign (bank) Head-Office or when not representing a solvability ratio of 8%. The PE may thus have to be provided with an appropriate amount of capital should its activity require to bear specific risks.

France	
	As mentioned above, thin capitalisation rules may not apply to French PE of foreign regulated credit establishments. Finally, French PEs of foreign banks resident in a country of the European Economic Area ("EEA") are not subject to the new "tax on systemic risk" (see part A.9). Save for the above rules, there are no specific provisions applicable to French PE of foreign bank establishments.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	*Please note that the following developments are not specific to banks. We however decided to include them in sake of completeness of this questionnaire.* 1. For interest paid by a French company to its controlling shareholders, the maximum rate for deductible interest is equal to the average annual interest rates offered by banks on loans of two years and over. It should also be mentioned that save for very limited cases, there is no WHT on interest paid by a French resident debtor to a foreign recipient. However, as a consequence of the recent anti abuse legislation, interest paid to bank accounts located in a Non Cooperative State or Territory ("NCST") will be subject to a 50% WHT.

France	
	2. Interest is subject to CIT. Dividend payments received might benefit from the participation exemption regime provided the conditions are met[8]. Specific rules apply for computing the tax credit amount (both dividends and interests are aimed) which can be set off against payable corporate income tax. (We only refer to a foreign WHT paid in a DTT country that might be creditable over French CIT) Broadly speaking, in order to compute the maximum amount that can be used as a tax credit derived from bonds and some type of loans, the bank is entitled to make a "global computation" instead of a transaction per transaction ceiling (as this is the case for tax credit attached to dividend). 3. Unless a specific exemption applies (i.e. payment of dividends to a parent company that is tax resident of the E.U. or exemption provided pursuant to a double tax treaty), dividends paid by a French bank to a foreign resident are normally subject to a 25% withholding tax (that could be reduced with foreign tax credits). The withholding tax is however increased to 50% should the payment be made on a bank account located in a NCST. Interest payments are classically not subject to withholding tax in France. However, as for dividend payments, a 50% withholding tax may be levied should the payments be made to a bank account located in an NCST. 4. Accrual basis. To be noted that, according to administrative guidelines,

[8] Participation exemption applies on dividends received from qualifying shareholdings (representing at least 5% of the company's share capital) held for an uninterrupted 2-year period.

France	
	interest received from doubtful receivables that have been transferred to a "compromised doubtful receivable" accounting item are not taken into account for the purpose of computing the taxable result of the year. The rule applies to bank, financial companies, investment companies ruled by article L.531-4 of the French Monetary and Financial code and certain companies having an activity of compensation of financial instruments. For those companies, the taxation of the interest is only delayed to its effective payment date (instead of its due date). 5 There is no WHT on interest provided the payment is not made to a bank account located in a Non Cooperative State or Territory ("NCST"). Should the payment be made to an NCST, a 50% WHT is levied. The question on the levy of the withholding tax when payment is made by the foreign PE of a French bank would need significant development that we believe is out of the scope of this high level questionnaire. Plus, the treatment is often to be investigated on a case by case basis and can hardly be generalised.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	There is no specific tax treatment applicable to banks. Classically, capital gains on fixed assets are taxable at CIT while capital losses are deductible from the taxable basis. A 95% exemption may apply on capital gains deriving from qualifying shareholding.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for	1) To be clarified but we believe our comments set in part A.1 above could reply to this question.

France	
tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	2) See our comments in part A.1 above.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	When it is ascertained that a debtor of the bank will not be in a position to honour its financial engagement, the bank may book a charge corresponding to the amount lost. Conversely, a reduction of the bank liability toward one of its creditors will crystallise a taxable profit in the P&L of the bank. When the receivable is considered "doubtful", a provision may be booked. (i) No (ii) The general provision will be deductible provided: - the default risk of the debtor can clearly be identified during the exercise; and - the risk of a future loss is highly plausible based on events occurring before closing of the exercise. In principle, the estimation of the default risk has to be made on a case by case basis, i.e. in consideration of the situation of each debtor. However, when internal risk estimation policy and related documentation could be provided, the FTA may agree to consider deductible a general provision booked by the bank.

France	
	(iii) Should one of the conditions stated in point (ii) be missing, the deduction of the provision will be refused. (iv) No. The specific provision (see point (v)+(vi) below) is only optional. However, should a specific provision be deducted by the company, booking and deducting a general provision will not be acceptable for tax purposes. In essence, the same doubtful receivable cannot justify the booking of both the general and the special provision. (v)+(vi) Article 39-1, 5° of the FTC and articles 2 and 3 *bis* of the Appendix 4 of the FTC entitle banks and credit establishments to deduct a specific provision for default risks over middle and long terms loans granted. The amount of the specific provision is capped at: - 5% of the accounting benefit of the bank - 0.5% of the amounts of credits effectively used. Point (v)/(vi) refer to a specific provision. This specific provision cannot be combined with the general provision mentioned above. The tax payer has to choose which provision to book over its receivable.
G. Tax treatment of employees stock option plans	
	Yes. It should be mentioned that until 31 December 2010, bank establishments which have received specific funds from the State were not entitled to grant

France	
1. Are employees stock options plan deductible for CIT purposes?	stock option plans to their CEO/Directors.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1. Please refer to part A above. 2. Please refer to part B above.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	- Please note that the financial bill for the year 2011 created a new "tax on systemic risks" specific to bank which will be paid in addition to contributions paid by the financial institutions to the deposit guarantee fund and supervision fees. In a nutshell, a 0.25% tax is assed on the amount of the bank's equity when exceeding EUR 500 million. As mentioned above, PEs of foreign banks resident in an EEA country are not subject to this tax. There is currently no mention in the law about the non deductibility of the tax from the CIT basis. We thus believe the tax on systemic risks would be deductible for CIT purposes. - A specific practice recognised by the FTA allows bank establishments to maintain the tax deductibility of certain accounting provisions related to assets (classically loans, bonds, notes) held in risky jurisdictions ("*provision pour risque pays*").

Germany	
A. General tax regime applicable to banks	
General comments	A bank levy is applicable from January 1st 2011 onwards and becomes annually due on September 30th. The bank levy is not tax deductible. The base for calculating the bank levy (annual levy) is the sum of 0.02 - 0.04% of the so-called "contribution relevant total equities and liabilities" and 0.00015% of the nominal amount of derivatives. Contribution relevant total equities and liabilities are defined as total equities and liabilities less liabilities to customers, less jouissance rights capital, less special balance sheet item "fonds for general bank risks" according to sec. 340g of the German Commercial Code, less equity capital . The bank levy amount is limited to a maximum of 15% of net profits plus certain other items and a minimum of 5% of the annual levy mentioned above. However, the specific rules such as the calculation of the bank levy may be subject to changes as the respective regulation has not yet become effective. The bank levy has been implemented as a contribution to a restructuring fonds and can therefore not be regarded as a tax. Wome discussions over a financial transaction tax have taken place in Germany, however there are currently no specific legislative proposals in this respect.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect?	1) There is no special tax rate for banks. Therefore the general CIT rate of 15% plus 5.5% solidarity surcharge thereon applies. Moreover, Trade Tax between 7% and 17.1% depending on the respective municipality rate becomes due. Commonly, this arises in an overall tax burden of approx. 30%. The applicable Trade tax rate for Berlin is 14.35%. 2) n/a 3) No, generally the CIT base for banks does not differ from those of other sectors. However, the 95% tax exemption on dividends and capital gains on the disposal of

Germany	
4. Do countries impose turnover taxes on gross interest and other income of banks?	shares does not apply for shares held by banks in the trading book. 3) Generally, according to sec. 4 no. 8 VATA (Value Added Tax Act) the core business of banks such as credit granting, depository banking and securities business is VAT exempt. But there is the possibility to opt for VAT under certain circumstances which is quite often used with regards to loan granting.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) There is no tax relief for any specific income but for expenses according to sec. 8 no. 1 TTA (Trade Tax Act) companies have to add back 25% of interest paid to its Trade Tax base. Thus generally 25% of interest paid by non-banks is not tax deductible for Trade Tax purposes. This rule generally does not apply for banks. Under sec. 19 TTO (Trade Tax Ordinance, this rule applies to credit institutions) there is only an add back of interest paid, in case that certain fixed assets (such as properties, plant, equipment, shares, receivables resulting of capital investments of dormant partners and jouissance rights) exceed equity. According to our experience most banks do not have to add back interest under this rule. 2) Thin Cap: The general German interest capping rule generally has no detrimental impact on banks as their interest income generally exceeds their interest expense with the result that there is no interest capping at the level of the respective bank. CFC: A foreign credit institution, financial services companies or finance company which has a domestic parent entity and predominantly performs its business with affiliated entities or persons is deemed as controlled foreign corporation according to German tax law if the income generated is subject to foreign income tax at a level lesser than 25%. Consequently, the income is treated as taxable income at the level of the parent. This may lead to an economic double taxation, if the income generated by the CFC is also subject to foreign (non-German) income tax. Please note that generally foreign credit institutions do not qualify as controlled

Germany	
	foreign corporation as their activities are deemed as non-detrimental for CFC purposes. The alongside comments refer to an exemption from this rule which lead to a credit institution being deemed as a CFC. 3) No. However, according to general German tax principles banks that have to be qualified as transparent from a German tax perspective (e.g. partnerships) or branches of foreign banks are not entitled to claim benefits under double-tax agreements. 4) There are no specific rules for subsidiaries of banks. With regard to branches of banks, specific rules within the German Administrative Principles for Branches apply, such as allocation of margins and receivables. In addition, interests on financing between a banking branch and Head-Office are recognized for tax purposes. Moreover, German branches of foreign banks need an allotted capital for tax purposes which has to be calculated on base of the risk weighted assets. In case that the allotted capital is not sufficient for tax purposes, the interest on the lacking amount will be added back to the tax base of the branch.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign	1) Interest paid is tax deductable for CIT purposes subject to the interest cap rules described under A.2 No. 2. Dividends distributed by a credit institution are treated as appropriation of earnings and are tax-neutral. 2) Interest and dividend received are treated as taxable income of the bank. However, according to sec. 8b par. 1 and 3 CITA the income resulting from dividends is 95% tax exempt as far as the shares are not held in the trading book. 3) On dividends 25% WHT plus 5.5% solidarity surcharge thereon are withheld at source. In case the investor is a German corporation the paid WHT may be deducted

Germany	
branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	within the tax assessment. In case the investor is a foreign corporate entity he could apply for a refund of 2/5 of the WHT. This means that the WHT burden would be reduced to 15% plus 5.5% Solidarity Surcharge thereon (totaling in a WHT rate of 15.825%). However, the foreign investor would only be authorized to benefit from the partial reclaim clause if it complied with the German anti-treaty-shopping rules. Under the German anti-treaty-shopping rule a foreign company is not entitled to full or partial treaty relief from WHT to the extent it has shareholders who would not be entitled to the same relief if they received the income of the foreign company directly, and ▪ there are no economic or other important non-tax reasons for the interposition of the foreign company; or ▪ the foreign company does not derive more than 10% of its gross income from its own commercial activities (this does not include income that the foreign company generates from the administration of its own assets (such as shareholdings), nor does it include activities that have been outsourced to other parties); or ▪ the foreign company does not have its own business infrastructure (e.g., office communication framework, employees) enabling it to participate in the business community. Furthermore, it may be possible to claim a partial (if not full) refund of the WHT suffered at source in Germany according to the applicable double tax agreement. However, in order to benefit from the double tax agreement the non-resident investor would also have to comply with the German anti-treaty shopping rules. Please note that dividend payments from a German-resident subsidiary to an EU-resident parent entity within the EC-Parent-Subsidiary-Directive qualify for a full

Germany	
	refund of WHT withheld at source provided that the parent entity complies with the German anti-treaty shopping rules. Furthermore, there is a possibility to exempt such dividend payments from Withholding tax at source by filing an application to the German Federal Central Tax Office prior to receiving the dividend payment. 4) In case the recipient is a German corporate entity the payments are recognized on accrual basis. In case the recipient is a foreign entity subject to a limited German tax liability the payments would immediately be treated as realized income for German tax purposes. 5) In case a domestic credit institution has to pay interest to a third party WHT of 25% plus 5.5% solidarity surcharge thereon (totalling in 26.375%) is withheld at source. However, this only applies if the third party as creditor is a domestic resident. In case the creditor is a foreign third party WHT would only be withheld in the single case that the receivable is secured by German real estate. Please note that an exemption from the obligation of a domestic bank to withhold tax on interest payments at source applies in case of domestic interbank loans. As far as a loan would have to be attributed to a foreign branch and the foreign branch pays interest to a third party, there should be no obligation of the domestic head office to withhold WHT on behalf of the branch.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Gains and losses on fixed assets are generally realized within the disposal of the assets and are fully taxable/fully deductible. Moreover, in case of an expected permanent diminution in value the fixed assets may be depreciated for tax purposes, which also result in a deductible loss.

Germany	
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) Discounts are treated as capital income (cf. sec. 20 par. 1 no. 8 ITA) and fall under the general CIT regime. The discount revenue is only realized when the party liable on a bill fulfils its obligation. If the payment on a bill is not made in the same year as the acquisition of a bill, then the discount revenue is only realized and taxable in the year of the payment on a bill. Please note that our comments refer to private persons only. However, credit institutions and other persons or entities which determine their profit by using balance sheets have to accrue the discount revenue. The credit institution has to tax the difference between the net present value at balance sheet date and the acquisition costs. 2) Financial instruments held-for-trading are measured at fair value since 2010, as far as they are not part of a valuation unit. Additionally, banks have to consider a risk deduction.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	Under local GAAP it is possible to make a specific allowance on bad debts or a general allowance on doubtful debts. Under German GAAP receivables have to be revalued at each balance sheet date. If a receivable is regarded as uncollectable (bad debt) it has to be depreciated. According to German tax law depreciation requires a permanent diminution in value. In case of doubtful debts an entity may perform a specific allowance and / or a general allowance. A specific allowance can only be performed if specific facts exist on the balance sheet date that substantiates the likelihood of a default of each respective receivable. A general allowance does not require a revaluation of each receivable. In fact, an entity may estimate the default risk of receivables based on the experience of the past. The German Federal Ministry of Finance has issued

Germany	
	special guidelines for general allowances for tax purposes in case of credit institutions described alongside. For tax purposes a specific allowance on bad debts is only possible if the entity anticipates a permanent diminution in value. The specific allowance reduces the tax base and is therefore deductible. The general allowance on doubtful debts will only be deductible by German fiscal authorities as far as it follows the respective guideline of the German Federal Ministry of Finance. E.g. the percentage for general allowance has to be computed by relating 60% of the average amount of bad debts (not exceeding the amount of specific allowance) to the average amount of credit risk of the preceding five years.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	The costs of stock options plans are deductable as expenditure for tax purposes in case that the issue of stock options is granted by purchasing own shares or transferring own shares to the employee. Please note, that the issuance of stock options by conditional increase in capital does not provide the right to deduct the stock options as personal expenditure. This is the same for financial and non financial sector.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Under local GAAP there is an option for depreciation of fixed financial assets in case of temporary decreasing value. For all other fixed assets depreciation has to be made in case of an expected permanent decreasing value. For tax purposes there is only an option to depreciate the assetsif a permanent decreasing value is expected. After introduction of the Accounting Law Modernization Act in 2010, it is possible

Germany	
	to exercise options for tax purposes independently from options under local GAAP. Credit institutions have an option to capitalize receivables, bonds, fixed interest bearing securities, stock and other non-interest bearing securities at a lower value than the respective value according to German GAAP as far this is deemed as necessary to protect against specific risks resulting from a credit institutions line of business. Please note that this option only exists for German GAAP but not for tax purposes. 2) No.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No

Greece	
A. General tax regime applicable to banks	
General comments	A draft tax bill has been submitted before the Greek Parliament on 21/2/2010. The bill is still in draft and under discussion; therefore the final provisions may be different than the proposed draft provisions. Reference to the proposed draft provisions is made below where applicable. The draft bill has been adopted by the Greek Parliament (L.3943/2011) and published in the Government's Gazette on the 31/3/2011; therefore reference below is made to the new provisions. The special levy of L.128 mentioned below under A4 could be viewed as a bank levy.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The CIT rate amounts to. 20% (the same as for other companies) and is applicable to accounting periods for which the annual tax return should be filed in 2012, e.g. accounting period 1/1/2011 -31/12/2011. 2) No. 3) Special rules apply to banks (and insurance companies) for the computation of the corporate tax base (article 99 par.1 of the Greek Income Tax Code). Key differences are outlined below: ▪ The taxable base of Greek banks is defined as the amount of the total net income or profits, generated in Greece or abroad, after the deduction of part of income corresponding to non taxable income (e.g. proceeds from Greek and EU mutual funds) or income subject to final taxation (namely interest on bonds and state bills, REPOS, etc.). This means, in practice, that non taxable income and income subject to final taxation (gross amount) is partly subject to annual CIT and part of it is not immediately subject to tax. This part derives from the following pro-rata formula:

Greece	
	Annual profit (after tax adjustments) x Tax Exempt/Subject to final tax Revenues Total Revenues (*) *(*) Excluding dividends or other tax neutral income and tax exempt profit booked in special reserves accounts such as securitization profit and capital gains from sales of listed shares.* The part that is not immediately subject to taxation is booked in a reserve. Banks are obliged to submit a respective tax return on the last day of the ninth month (i.e. September 30th) from the end of the fiscal year, in which the above reserve was formed, so as to pay tax at the standard CIT rate on the reserve's balance (art. 106 par. 12 of the Greek ITC). Therefore, the taxation of non taxable income and income subject to final taxation is effectively deferred for a few months. In the event that there is no sufficient annual profit (after carry forward accounting losses) to book a reserve as per the above, non taxable income and income subject to final taxation will be included in the taxable income. The withheld tax that corresponds to the period that the Bank had in its portfolio the securities in question (i.e. securities generating income subject to final taxation, namely bonds and state bills) is credited (deducted from) the CIT. According to the position consistently taken by the tax authorities the tax credit is up to the corresponding annual tax. Moreover, based on the provision of article 10 par.3 of L.3842/2010, the credit tax amount arising from the CIT tax returns of FY 2010 (accounting periods 2009) submitted by Banks is not refunded to the extent it represents tax withheld on bond interest. Effectively, the above tax treatment may result to increased taxation for banks, in case the amount of tax withheld on gross interest income is higher than the total tax liability of the Bank. To be noted that many Greek Banks and Greek branches of foreign Banks have initiated litigation procedures before the Greek Administrative Courts requesting the refund of the credit tax amount corresponding to the WHT on bond interest. ▪ According to art. 31, par. 8 of the Greek ITC there is a formula based on which

Greece	
	expenses corresponding to non-taxable income are not treated as tax deductible. The non-deductible amounts are: ▪ The amount of the debit interest calculated on a pro-rata basis (between taxable income and non taxable income or income subject to final taxation). **This provision is not applicable to banks.** ▪ An amount equal to 5% on the non taxable income or income subject to final taxation or income from participation in Greek companies, which cannot exceed the 20% of the total expenses. **Specifically for banks, only the 5% on the profits derived from dividends and profits from participations in other Greek companies is added to their taxable income as non-deductible item.** ▪ For all Greek companies, capital gains arising from sale of listed shares are booked in a special reserve account which can be used to offset future losses from the sale of listed or non-listed shares and losses arising from valuation. Moreover, capital gains arising from listed derivatives are booked in a special reserve account to be used to offset losses from the same cause. These reserves accounts are subject to tax upon distribution or capitalization. (*NOTE: based on new bill capital gains on the sale of listed shares initially acquired as of 1/1/2012 shall be subject to tax based on the general provisions and only the capital gains from listed derivatives shall continue to be booked in this special reserve account*). Banks in specific are obliged to submit a respective tax return on the last day of the ninth month (i.e. September 30th) from the end of the fiscal year, in which the above special reserves were formed, so as to pay tax at the standard CIT rate on the special reserves balance (art. 106 par. 12 of the Greek ITC). Therefore, for Banks the taxation is effectively deferred for a few months. Other companies do not file this return. ▪ The pre-payment of the tax for the next financial year is equal to 100% of the CIT due based on the final CIT return filed by the Banks (whereas for other companies the pre-payment is calculated at a rate of 80% on the CIT due). 4) No. To be noted that Bank debt is subject to a special levy of L. 128/75 (0.6%

Greece	
	annually on the loan value – art. 19 of L. 3152/2003). Such a special levy is imposed on loans provided by Greek and/or foreign credit institutions. In case of loans extended by Greek Banks and Greek branches of foreign Banks, the levy is reported and paid directly by the bank/branch to the Bank of Greece on the basis of the average monthly balance on the last working day of the month following the month that relevant amounts correspond to. In practice the cost is carried over to borrower. This special levy can be viewed as a bank levy
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) No. 2) No. Moreover, Thin Cap rules (interest corresponding to loans exceeding the 3:1 debt to equity ratio is not recognized as tax deductible) applicable to other companies are not applicable to banks operating in Greece (art. 31, par. 1, case d of the Greek ITC). 3) No. 4) No. The same tax rules apply to subsidiaries and branches of foreign banks.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT	1) The same: interest paid is recognized as tax deductible subject to certain conditions set by the law. Distributed dividends are subject to a WHT: refer to point 3. 2) Interest income is taxable. Specifically, for Banks interest on bonds, state bills, REPO transactions, is subject to a 10% final tax (please refer to question A.1. (3) with respect to the tax treatment of income subject to final taxation). Dividend income is treated the same as with other companies. Domestic dividends are not included in the

Greece	
perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	taxable base of the recipient. Foreign dividends are taxable with a credit being provided for the tax paid abroad. The new L.3943/2011 introduced a participation exemption system, based on which dividends received by EU subsidiaries are not subject to tax provided they are booked in a special reserve account. 3) A WHT at the rate of 25% is due (for profits distributions during 2011 the applicable WHT rate is 21% WHT), which can be reduced by application of a DTT or the EU Parent-Subsidiary Directive. 4) The same: interest income is recognized for tax purposes when it becomes mature and due. 5) Under domestic law a WHT may be due on interest payments depending on the payer (individual or legal entity) and the recipient of the interest income (Greek or foreign). In any event no WHT is due in case of payment of interest by a foreign branch of a Greek bank to a third party. As a general rule interest paid to foreign recipient is subject to a 40% WHT, which can be reduced by applying a DTT or the Interest-Royalty Directive. Despite the above, the answer to your specific question is that no Greek WHT is due.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	The same as for other companies: Gains or losses arising upon disposal of fixed assets are respectively treated as taxable income and tax deductible expense.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes?	1) The same as for other companies. With respect to the valuation for tax purposes, securities either listed or non-listed and other financial instruments held by Banks are valued at year end as a portfolio at the lower value between the acquisition value and the fair market value (whereas other companies do not value their portfolio as a whole, but each security/financial instrument separately). For all companies, including

Greece	
2. How are assets held for trading purposes treated for tax purposes?	Banks, the valuation loss is not tax deductible, but it can be booked in a special reserve account to offset capital gains from the sale of listed shares – please refer to answer A.3. above). 2) There are no general or special tax rules on assets held for trading purposes.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i) The Banks are entitled but not obliged to form general and specific provisions for bad debt on advances and loans. (ii)- (iii) Only banks are entitled to deduct for tax purposes a general provision at the rate of 1% (or 2% for Investment Banks, the term is not clearly defined in Greek Law) on the annual average of their advances, these comprising capital and receivables except for doubtful or non-collective interest related to doubtful or non-performing advances, which are monitored off-balance sheet in memo accounts, loans to the State and State-owned enterprises or loans guaranteed by the State (art. 105, par. 4, case c of the Greek ITC). (iv)- (vi) Furthermore pursuant to par. 5 of art. 105 of the Greek ITC, specific provisions are booked for certain non-performing loans. These provisions should be utilised for respective write-offs within 8 FYs starting in the year within which they were booked. In case where these amounts are not written-off during the 8 FYs, the Bank should submit a supplementary Income Tax return and suffer tax on the non utilised amount, plus late payment penalties.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	The same as for other companies. : The tax deductibility of the expenses paid by companies, including banks, within the framework of stock options plans is not regulated by an explicit provision. The treatment is unclear; based on some recent private rulings – which are not binding by force of law– the Ministry of Finance seems to adopt the position that said expenses are not tax deductible.

Greece	
	Although not related to the deductibility of stock options plans, according to the art. 14 par. 9 of L. 2238/94 (inserted to it by the art. 8 par. 14 L.3248/2010), bonuses (benefits in cash, on top of regular remunerations and overtime payments) paid to executives of credit institutions until 2013 (i.e. financial year 2012) are taxed based on the general progressive tax scale applicable to individuals provided the total annual income of the executive does not exceed 60,000 Euros and the amount of the bonus does not exceed a percentage of 10% of the total annual regular remuneration (upper band 45%). For amounts exceeding the above, taxation at source is based on a progressive tax scale. For amounts exceeding Euro 80.000 the applicable WHT rate is 90%. Said tax is withheld by the credit institution at the time of the payment of bonus amount to the beneficiary employee. The above also applies in case of benefits granted from the profits of the credit institutions. Therefore, the grant of shares as dividend in kind by a credit institution to its employees within the framework of a profit distribution may be caught by this provision. To be noted that the application of abovementioned provision is limited in time, since it will apply to cash bonuses paid, up to the fiscal year 2013 (i.e. bonus paid during the accounting periods for which the annual corporate income tax return should be submitted during the calendar year 2013).
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Greek anks are obliged to maintain their accounting books based on IFRS. Therefore, their accounting practices and respective discretions depend on the IFRS accounting rules. 2) No. Tax rules apply equally to subsidiaries and branches of non-domestic banks.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	N/A

Hungary	
A. General tax regime applicable to banks	
General comments	
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The CIT rate (10% up to HUF 500 billion tax base, 19% above) is the same as for companies in the non-financial sector. The local business tax rate in Budapest for both banks and companies in the non-financial sector is 2% (further details please see A.4). It is noted that the local business tax base is determined differently from the tax base of the corporate income tax. We note that banks are also subject to a special bank tax. In practise, the computation is as follows. Banks have to calculate their tax liability in two different ways: 1) they have to calculate 30% of their pre-tax profit ("profit-based tax"); 2) they have to calculate their adjusted balance sheet total of 2009 multiplied by the applicable progressive tax rate ("balance sheet-based tax"). The actual special tax liability will be the profit-based tax up to the amount of the balance sheet-based tax. If the balance sheet-based tax is higher, the excess tax should be paid in addition. 2) No special CIT rate. 3) Generally, the calculation of the corporate income tax base is the same as for companies in the non-financial sector (it is also governed by the same act), although there are 4 exceptions: ▪ Certain provisions: expenses accounted due to provision are deductible for CIT purposes, revenues accounted due to the release of provision are taxable for CIT purposes. Please note that these rules are only applicable to those provisions that were accounted due to the special nature of the financial sector's activity e.g.: on bank risk ("általános kockázati céltartalék" However, regarding general provisions for expected liabilities and future expenses (i.e.

Hungary	
	regarding the provisions not accounted for based on banks' special accounting rules), banks and companies in the non-financial sector follow the same rules (expenses due to the creation of provisions are not deductible, revenues due to the release of provisions created earlier are not taxable). ▪ Loss in value (more details in A.6.) ▪ Thin capitalization (more details in A.2.) ▪ Loss carry forward (losses incurred in and before 2008 cannot be carried forward for banks, from 2009 it is possible). 4) Local business tax (at a rate of up to 2%) is also levied on banks as levied on all companies in the non-financial sector by the local municipality. The difference is in the "net sales revenue" part of the tax bases. Other adjustment items are the same. For banks, the "net sales revenue" is the difference between interest received and paid, plus any revenues from financial, non-financial, investment and non-investment services activity and the net gain of derivative and hedged transactions. On the other hand, the "net sales revenue" for companies in the non-financial sector is the adjusted net sales revenues.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits?	1) No special tax relief. 2) Generally, the same anti-avoidance rules (e.g. CFC, substance-over-form, thin cap ratio etc.) are applicable for banks as for companies in the non-financial sector. Only regarding thin capitalization, there are some exemptions from such rules for banks. Namely, when calculating the debt-equity ratio (3:1) for thin capitalization

Hungary	
3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	purposes, banks do not have to take into consideration their liabilities in connection with their financial services activity. 3) No. 4) No difference.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) No difference between banks and companies in the non-financial sector. In relation to dividend paid there are no special tax rules i.e. the tax treatment follows the accounting. In relation to interest paid only the thin capitalization rules have to be taken into consideration. Otherwise, the tax treatment follows the accounting treatment. 2) No difference between banks and companies in the non-financial sector. Generally, dividend received is exempt from corporate income tax purposes except when it is received from CFC. Interest received is subject to corporate income tax. 3) No WHT on dividend under domestic regulation either for banks or companies in the non-financial sector. 4) No difference. The general rule is the accrual basis accounting. 5) No WHT on interest paid to foreign corporate entities under domestic regulation. No difference in the case of banks or companies in the non-financial sector. If the foreign branch is situated in a country with which Hungary concluded a double tax treaty with, then the interest paid by that branch will not be subject to Hungarian domestic withholding tax rules. In this case the WHT rules of the foreign branch's country are prevailing. If the foreign branch is not situated in a country with which Hungary concluded a double tax treaty with, then the interest paid by that branch could be subject to 30% WHT in Hungary in 2010 (the applicability of

Hungary	
	the WHT regime of the respective foreign country should be analyzed separately). This 30% WHT was however abolished from 1 January 2011.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Gains are generally taxable, losses are generally deductible. No special rules for banks.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) No special tax rules i.e. the tax treatment follows the accounting treatment. 2) No special tax rules i.e. the tax treatment follows the accounting treatment.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	General rules: According to the general rules for companies in the non-financial sector bad debts are deductible from the CIT base, but only up to the amount of the previously accounted impairment (if any). This is due to the fact that such impairment was not tax-deductible. Specific rules: In the case of banks, as impairment of debts from financial and investment services activity is a deductible expense for CIT purposes, the corresponding bad debts will not decrease the CIT base any further. Please note that provisions for banks risk is described in Section A.1.3. as an example. (Debts from other activities will be treated according to the general rules applicable for companies in the non-financial

Hungary	
	sector). Realized losses are tax deductible.
G. Tax treatment of employees stock option plans	
2. Are employees stock options plan deductible for CIT purposes?	No special tax rules i.e. the tax treatment follows the accounting treatment, i.e. when expense is accounted for, such expense should be deductible for CIT purposes.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Both banks and companies in the non-financial sector may create a revaluation reserve for their fixed assets and long-term financial investments if the market value significantly and permanently exceeds the book-value of such assets. This revaluation reserve directly increases the company's capital. As opposed to this, no revaluation may directly decrease the value of the capital. 2) No.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No

Ireland	
A. General tax regime applicable to banks	
General comments	There is no bank levy applicable, Financial Activities Tax and there are no (pending) proposals in this respect.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) Corporate income tax rate (no difference between FS and non-FS cases): ▪ 12.5% on trading income ▪ 25% on passive income ▪ 10% surcharge for late filing returns No specific local taxes, the rates above are charged to all businesses. 2) No special corporation tax rate is applicable for banks. 3) Financial institutions are liable for corporation tax on their profits in the same way as other companies. In computing profits or gains of a trade chargeable to corporation tax, generally accepted accounting practice ("GAAP") must be followed, subject to any adjustments required or authorised by law. For this purpose: ▪ GAAP means International Accounting Standards ("IAS") in relation to a company that prepares accounts in accordance with those standards or if not, Irish GAAP, ▪ Irish GAAP means the generally accepted accounting practice of companies incorporated or formed under the laws of Ireland being accounts intended to give a true and fair view, and ▪ "adjustments required or authorised by law" includes adjustments in

Ireland	
	accordance with both legislation and case law. IAS (IFRS) must be applied in certain circumstances but, otherwise, companies may choose to apply either IFRS or local GAAP. Where a company makes up accounts per Irish GAAP, the accounting profit is the start point for tax purposes and this is adjusted in accordance with Tax Law (both Case Law & Statute) While IFRS accounts may be the subject to some adjustment in relation to established tax rules, the level of adjustment is generally not as significant. E.G.: ▪ Bad Debts - no tax adjustment if under IFRS; general provisions disallowed if under Irish GAAP ▪ Profits on disposals - no adjustment if under IFRS; Unrealised gains/losses adjusted out if under Irish GAAP. No difference in the treatment of trading items as between FS and non-FS. The position at present is somewhat fluid due to some companies being in the process of graduating to IFRS from Irish GAAP 4) No. Financial services are VAT exempt.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to	1) No specific tax relief rules for items such as interest income. Interest income on bank accounts generally accrues on a day-to-day basis and is recognised on this basis for tax purposes irrespective of the date on which it is charged to the customer. Other interest, premia and discounts that are commercially in the nature of interest (for example, original issue discount and predetermined premium on redemption), when they arise in the course of a trade are also generally

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avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	taxable as and when they are included in the profits in the audited financial statements of a banking institution. (=Subject to the anti-avoidance measure, interest (or premia, discounts etc.) that are accounted for on a paid basis rather than on an accruals basis will generally be taxable as per the financial statements) However, interest that is received in the course of a lending trade, which has not already been included in that lender's taxable trading profits, is to be taxed when it is received rather than in a later taxable period. This is irrespective of when that interest accrues or arises to the lender. This means that both interest accruing as part of a trade for a taxable period and interest prepayments that are trading receipts received during a taxable period are included in the trading profits of a lender. 2) Generally there are no Thin Cap rules in Ireland. Interest paid by a resident company to a 75% non-resident group member is treated as a distribution and is not deductible for Irish tax purposes, unless the interest expense is incurred for trading purposes and the required election is made (the election is only available in respect of yearly interest). The 75% applies to a direct or an indirect holding. This was originally an anti-avoidance measure, which is effectively obsolete for EU and Treaty Countries due to the election available not to apply the provision. Where the interest payments are being made to countries outside the EU with which Ireland does not have a DTA, it may be more beneficial to opt not to elect and have the interest payments treated as distributions. There is an exemption from withholding tax on the payment of any dividend to a parent company where the principal class of shares of its ultimate parent company, are substantially and regularly traded on a recognised stock exchange in a tax treaty country. While the company would not get the benefit of the interest expense deduction at the rate of 12.5%, it would not suffer the cost of any withholding tax at the rate of 20% (arising due to the fact that payments are made to non EU/ non DTA countries), giving a tax benefit of 7.5% to the company. No CFC rules in Ireland.

Ireland	
	Ireland has introduced transfer pricing legislation which applies for accounting periods commencing on or after 1 January 2011 in relation to any arrangements entered into on or after 1 July 2010. 3) Generally, no. Certain types of funds may not qualify in respect of some of the double tax agreements Ireland has entered into. 4) Foreign subsidiaries are outside the scope of Irish corporation tax. Irish subsidiaries of banks are liable for corporation tax on their profits in the same way as other companies. **Foreign branch of Irish bank** An Irish company is liable to corporation tax on its worldwide income, this includes income arising in its foreign branches. Double tax relief should be available in Ireland in respect of tax incurred by the branch in the foreign jurisdiction. **Irish branch of foreign bank** A company not resident in Ireland is subject to Irish corporation tax if it carries on a trade in Ireland through a branch on its trading income arising directly or indirectly through or from the branch and any income from property or rights used by, or held by or for, the branch. In order to be tax-deductible as interest, interest expenses must actually be incurred, i.e., there is no deduction available for notional interest. However, reasonable interest charges appropriately apportioned by a non-resident head office to an Irish branch of a bank are an allowable deduction in the same way as other costs incurred. In particular, where the company is resident in a state with which Ireland has a double tax treaty, the deductibility of a reasonable proportion of head office expenses is reinforced by the usual rule that the profits of the branch be computed for Irish tax

Ireland	
	purposes as if it were an independent enterprise.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	**Interest paid/ funding costs** There are no specific rules regarding the deductibility of these costs for banks and other financial institutions. Interest paid by a bank will generally be either a Case I deduction or a charge on income. In order to qualify for a Case I deduction, the interest must be of a revenue nature, wholly and exclusively incurred for the purpose of the trade and not statutorily prohibited as a deduction. This is in line with general principles for any Case I deduction. Irish tax legislation treats certain interest as a distribution for Irish tax purposes including interest paid insofar as it exceeds a market rate or where it is to any extent dependent on the financial results of the business. In practice, with regard to the tax deductibility of interest on a loan obtained in the ordinary course of the trade, generally a distinction is not made between interest payable on debts forming part of the long-term capital of a bank and interest payable on debts forming part of the circulating capital of a bank. However, it is important to note that in the case of banks Revenue practice is to disallow interest that is attributable to funds that form part of the Tier I regulatory capital of the bank. This is on the basis that interest on Tier I regulatory capital is by its nature akin to a distribution. Therefore, unless arising on Tier I regulatory capital, interest wholly and exclusively incurred for the purpose of a banking trade would normally be a deductible expense in computing the taxable profits of that trade whether or not the debt is on capital or on revenue account. Also, the costs of issue of capital debt will be tax deductible in accordance with Revenue practice where the tenor of the debt is expected to be less than ten years.

Ireland	
	Connected party interest The Irish tax legislation provides that in certain circumstances the deductibility of interest that would be allowable for corporation tax purposes is restricted. This restriction only applies where interest is payable either directly or indirectly by a person to a connected person who is resident in Ireland for tax purposes or who is ultimately under the control of persons resident in Ireland for tax purposes. Where interest is a trading expense of the person by whom it is payable, it is only deductible insofar as it is comprised in the taxable income of the connected person to whom it is payable. **Tax exempt income and interest** It may, on occasion be the case that a bank would incur interest charges in earning income which is exempt from taxation. However, there is no general preclusion from obtaining a tax deduction for such interest unless there is a specific provision requiring it. **Tax Based Loans – Interest Treated as a Distribution** As mentioned above, certain provisions in Irish law re-characterise certain interest payments made by a company as distributions of the company. A deduction for tax purposes is not available in respect of such interest, because a distribution is an appropriation of profits rather than a deduction in arriving at profits. Any such interest receivable is taxable as a distribution in the hands of the recipient if an exemption is not available subject to certain very limited exceptions. The Irish tax legislation outlines certain circumstances where interest is characterised as a distribution. However, Irish tax legislation provides that Irish licensed banks or persons who hold a licence or other similar authorisation under the law of any other EU Member State, incurring such interest in the course of their banking business in Ireland, where that interest is charged at an arm's length rate and would otherwise be

Ireland	
	tax deductible, may elect that such interest is not treated as a distribution. **Dividend paid** Dividends paid treated as a distribution and no deduction is available for corporation tax purposes 2) **Interest received** See question B (1) above **Dividend received** An Irish resident company is not chargeable to tax on a distribution received from another Irish resident company other than on dividends from certain preference shares. Foreign dividends received that form part of the income of an Irish resident company may be treated as trading income where that income arises in the course of the company's trade. Foreign dividends received by an Irish company where it holds no more than 5% of the share capital and voting rights in the foreign company will be exempt from corporation tax. This exemption will only apply where the Irish company is taxed on this dividend income as trading income. This measure was introduced to give effect to the ECJ ruling in the FII GLO case Foreign dividends from underlying trading profits sourced from (a) an EU country, (b) a country with which Ireland has a DTA, or (c) a non-EU/ non DTA country provided the company is a 75% subsidiary of a company, the principal class of shares in which are substantially and regularly traded on a recognized stock exchange in Ireland, the EU, a treaty country or on such other

Ireland	
	stock exchange as may be approved by the Minister for Finance will be taxed at the 12.5% rate. The full amount of the foreign dividend will be chargeable at the 12.5% rate when certain conditions are met, even though part of the dividend may not be paid out of trading profits. These conditions are: ▪ 75% or more of the dividend paying foreign company's profits must be trading profits from that company or lower tier companies resident in the EU or in a country with which Ireland has a double tax treaty; and ▪ on a consolidated basis, the aggregate value of the trading assets of the company that receives the dividend and all of its subsidiaries, must not be less than 75% of the aggregate value of all of their assets. If these two conditions are satisfied, there is no apportionment of the dividend received, between the 12.5% and 25% rates of tax. All of the dividend will be taxed at the lower 12.5% rate. Otherwise the dividend will be apportioned between the two rates. In taxing foreign sourced dividends, credit is available for any foreign withholding taxes suffered or underlying taxes on profits out of which the dividend is paid. Finance Act 2004 introduced a form of onshore pooling so that, where foreign dividends have suffered foreign tax in excess of the Irish rate, excess foreign tax credits in respect of these dividends may be offset against Irish tax on dividends which have suffered foreign tax at a rate lower than the Irish rate. i.e. excess foreign tax credits can be pooled. All other foreign dividends are subject to corporation tax at the passive rate of 25%. 3) The domestic withholding tax rate is 20%. Dividend withholding tax in most cases is eliminated by domestic law rather than treaties. Dividends from an Irish resident company to parent companies resident in the EU are exempt from dividend withholding tax under the EU Parent Subsidiary Directive.

Ireland	
	There are also a wide range of domestic exemptions from dividend withholding tax including an exemption for non-EU based treaty recipients (not under the control of Irish residents) and an exemption to apply where the 75% ultimate parent of the recipient is listed and the shares are substantially and regularly traded on a recognised stock exchange. 4) On the assumption that the entity is trading for Irish corporation tax purposes, the tax treatment should follow the accounting treatment of the interest. 5) There is an exemption from the general requirement to withhold tax on interest payments made by a bank carrying on a bona fide banking business in the State. Deposit Interest Retention Tax, or DIRT as it is commonly known, is a withholding tax on the consideration paid by certain banking institutions, known as relevant deposit takers, on certain deposits, known as relevant deposits, which if the correct procedures are followed is usually limited in application to the returns on deposits or investments of Irish resident individuals. Technically all deposit interest is liable to DIRT, however non - residents can obtain an exemption on proof of non - resident status. Where a foreign branch of an Irish bank pays interest to a third party, no Irish withholding tax should arise, rather you must look to the withholding tax legislation in the country where the branch is situated.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Gains and losses arising on the disposal of fixed assets (i.e. non-wasting assets) are subject to capital gains tax at the rate of 25%. The assets are the subject of the Capital Gains tax regime, therefore capital losses are available for set off, provided the capital loss arises in either the same accounting period as the capital gain or in a preceding accounting period; capital losses cannot be carried back against capital gains arising in a preceding period

Ireland	
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) Where such discounts arise in the ordinary course of the banking trade they should be treated as trading receipts and are liable to corporation tax. 2) Where assets held for trading purposes are disposed of, any profit (or loss) arising on disposal forms part of the bank's trading income (allowable expenses) of the bank.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	If the company prepares its accounts under IFRS, the tax treatment of bad debts will follow the accounting treatment. Where the accounts are prepared under Irish GAAP: (i) No deduction will be available for corporation tax purposes in respect of general provisions. (ii) As above at (i) (iii) As above at (i) (iv) A deduction is available in respect of specific provisions provided the bad debt is a known liability and accurate calculation of same. (v) As above at (iv) (vi) As above at (iv)
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	For Irish corporation tax purposes, share schemes granted to employees would be tax deductible if;

Ireland	
	(i) they have been actually incurred (i.e. paid) by the local company, (ii) the costs are wholly and exclusively for the purposes of the trade of the local company, (iii) the local company can demonstrate that the Irish trade has benefited from the participation of its employees in the scheme and that the cost is commensurate with the awards/benefits being provided, (iv) they are revenue, as opposed to capital, in nature, and (v) the costs incurred by the local company in respect of share schemes of the parent company must be at arm's length.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) There is no difference in the treatment of capital for banks as compared to other entities. There is very little discretion within each accounting framework in the accounting for capital though there are some differences as between Irish GAAP and IFRS as regards the treatment of capital instruments. The selection of the accounting framework is partially at the discretion of each entity, but entities with listed equity must choose IFRS. 2) The same rules will apply to both domestic and non-domestic entities, subject to them being governed by the same accounting framework.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No

Italy	
A. General tax regime applicable to banks	
General comments	At the moment in Italy there is no "bank levy" or "financial activities tax" and, as per our knowledge, there are no pending proposals of law in this respect.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1)The applicable Corporate Income Tax rate is 27.5%, while the applicable rate for the local tax (Regional Income Tax) in general is 3,9%, for the Italian Banks (and other financial entities) is increased up to 4,82%. Since the introduction of IRAP, in 1997, the tax rate for financial companies was higher than other sectors (5.25% for financial companies and 4.25% for other companies). Starting from fiscal period 2008, the rates have been reduced to 4.82% for financial companies and 3.9% for other companies. Being a local tax, the above-mentioned rates may vary in Region by Region (for instance: in some Regions both financial companies and other companies are subject to the 4.82% rate; in other regions the rate has been increased to 4.93%). 2) The banks do not receive a special Corporate Income tax rate, but they can be qualified for a higher Regional Tax Rate for IRAP purposes. As general rule, financial companies are subject to higher IRAP rate, nevertheless in some regions the IRAP rate is the same both for financial companies and other companies. No particular conditions are requested, just the "financial entity" status. 3) In general the Corporate Tax Basis derives from the results of the Profit and Loss Account. To compute the Corporate Tax Basis the banks apply the IAS Accounting Principles, while, generally speaking, the other companies apply the Italian GAAPs. The IAS Adopters (i.e. entities which prepare the Financial Statement according the International Accounting Standards) calculate the Corporate Tax Basis on the result arising from the P&L and also for tax purposes it is relevant the qualification, classification and time allocation criteria provided for IAS principle. For Regional Income Tax (IRAP) purposes, the Italian Banks determine the

Italy	
	Regional Income Tax Base by the sum of the following income statement items: ▪ Operating Income decreased by 50 per cent of dividends; ▪ The amortization of tangible and intangible assets for an amount equal to 90 cent ▪ The other administrative expenses in an amount equal to 90 percent. ▪ Labor costs are only partially deductible. In principle the differences in the computation of the taxable basis for Banks and other companies should be aimed to consider the different features of the different activities, nevertheless the fact that banks include in the taxable basis 50% of dividends, while manufacturer companies do not include dividends in its IRAP taxable basis can be seen as a disadvantage for Banks. Companies active in other sectors apply rules which are linked to the P&L format sets for the specific activity sector. 4) No, Italian Tax Authorities do not impose turnover taxes on gross interest and other income of banks.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits?	1) In Italy there are no specific tax relief rules for items connected to the business of the banks. 2) There are specific anti-avoidance rules (CFC, etc..) which in principle are applicable to all tax-payers including banks. The Italian tax law doesn't provide a Thin Cap rule at the moment. There are in force CFC rules aimed to tax in Italy profits realized" in "tax haven" jurisdictions through controlled or related foreign subsidiaries or enterprises. The CFC rules apply both to banks and other Italian tax

Italy	
3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	payers. 3) The Italian banks, being subject to tax in Italy, in principle are allowed to benefit of double-tax agreements concluded by the Italian State. Other financial entities (i.e. mutual funds, etc.) may suffer from some limitations. 4) Subsidiaries and branches of foreign banks are subject to the same tax treatment applied to Italian banks. Nevertheless, for subsidiaries and branches of foreign banks the fair value of the intercompany transactions and the presence of a proper endowment fund (for the Branches) are carefully monitored by the Tax Authorities. When foreign banks set up a branch in Italy without a proper allocation of capital (endowment fund) to the branch, the Italian tax authorities challenge the deduction of passive interests paid by the branch in relation to the amount of loans that, in the tax authorities' view, should be replaced by capital.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Dividends paid: they are not deductible from the income tax basis of the distributing company (same treatment for banks and other taxpayers). Interest paid: the Interest expenses incurred by the banks are deducted from the Corporate Tax basis at 96 per cent of their total amount. This percentage is provided. This percentage is provided for by the law and has no specific rationale. For the entities, other than those belonging to the financial sector, interest expenses can be fully deducted (provided that interest expenses meet certain limits stated in the Income Tax Code) 2) Dividends received: Generally dividends received are taxed at only 5 percent of their amount. For the IAS adopters (including banks) dividends on shares classified in the held for trading

Italy	
	portfolio are fully relevant for Ires purposes. In other words, for IAS adopters, dividends relating to HFT shares can not benefit of the 95% exemption. The rationale of this rule is connected to the fact that also capital gains/ and losses realized on HFT shares are taxed/deducted. Interest received: Both for financial companies and for companies belonging to other sectors, interests received contribute to the formation of the Corporate Tax Base for their full amount 3) Dividends received from an Italian bank are not subject to withholding tax in Italy. Dividends paid by an Italian company (including banks) to other Italian companies or foreign entities are subject to the following tax regimes: ▪ no WHT If paid to Italian companies; ▪ no WHT if paid to companies resident in EU Member States under the provisions of EU Parent-Subsidiary Directive (as implemented by the Italian tax law); ▪ 1.375% WHT if paid to other European companies subject to the CIT in one of the EU Member State or in an EFTA State; ▪ 11% WHT if paid to pension funds set up in the EU Member State or in an EFTA State; ▪ 27% WHT if paid to non-residents other than those listed above. This rate decreased to 12.5% if the dividends are related to savings shares. Moreover the WHT rates can be reduced according to the provisions of double tax treaty

Italy	
	when applicable. "Saving shares" are shares without voting rights. Compared with "ordinary shares" (having voting rights), saving shares grant to the owner some additional economic benefits. 4) The Italian banks, as IAS adopters, tax and deduct the interests, based on the method of accounting used to draft the Profit and Loss Account, in accordance with IAS/IFRS principles. 5) Yes. Pursuant to the Italian domestic law , WHT must be levied on interest paid to third parties. There are different WHT on interest paid to third parties that vary depending on ▪ the nature of the interest paid ▪ the individuals involved in the financing. ▪ Generally speaking, interest on loans and advances paid to foreign entities are subject to a 12,5% WHT. The Italian tax law does not provide any "recapture rule" aimed to apply WHT on passive interests paid by a branch located abroad.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	For Italian banks, in principle, gains and losses realized on fixed assets (other than shares or quotas) are taxed or deductible. The same treatment is valid also for non FS sector. On the other side the year end evaluations are not tax relevant, except in specific cases. (i.e: the year end evaluation of securities other than shares or quotas).This specific tax rule prevails over the general rule also for IAS adopters.

Italy	
	Quotas are "unity of capital" of "Società a responsabilità limitata – Srl" (limited stock companies which do not issue shares).
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	In principle the discounts on government bills, on trade bills and on other instruments are taxed in the hand of the investors as interest. Incomes and costs related to held for trading assets (accrued in the Profit and Loss Account in accordance with IAS principles) are fully relevant for IRES purposes (=income is taxable and costs deductible).
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	For the Italian banks, bad debt provisions on advances and loans accounted in the balance sheet, for the amount not covered by insurance guarantee, which arise from the operations of lending to customers, are deductible, in each tax period, within the limit of 0.30 percent of the value of the credits accounted in the balance sheet, increased by the amount of the write off recorded during the fiscal year. The total amount of the devaluations that exceeds 0.30 per cent is deductible in equal installments during the eighteen subsequent tax periods. The rule described above is applicable both to general provisions (reducing the value of the loans in the balance sheet) and to specific provisions. Consequently, the rule applies to the total amount of specific provisions and general provisions recorded during the fiscal period.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Italian banks generally deduct the costs of the employees stock options plans for CIT purposes according to the IAS/IFRS criteria. However the tax rules on this specific aspect is not clear and the tax authorities have not validated yet the behavior

Italy	
	kept by the banks. For sake of completeness be informed that the Italian government has recently introduced a provision that provides for a higher tax burden in the hand of the employees who receive the benefit of the stock option plans .
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1)The Italian banks are required to properly apply the evaluation criteria provided for by the IAS/IFRS principles. 2) No, the provisions applicable to the Italian banks are the same as those applicable to subsidiaries and braches of non-domestic banks.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	In principle, actual practices are compliant with the legal provisions.

Latvia	
A. General tax regime applicable to banks	
General comments	Recent development: Latvia has introduced financial stability duty payable by Latvian banks, foreign branches of Latvian banks and Latvian branches of foreign banks, in force from 1 January 2011. The duty of 0.036% per annum is assessed on the bank's liabilities less a) deposits subject to guarantee scheme in Latvia or other EU member states, b) mortgage bonds issued by the respective bank and c) subordinated capital accounted in the bank's shareholders equity.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The standard CIT rate in Latvia is 15% and it is applicable to all sectors including the financial sector. There are no local taxes. 2) No. 3) Yes, special provisions for bad and doubtful debts are fully deductible for CIT purposes the year in which they are created. Tax payers in other sectors are not allowed to deduct special provisions for bad and doubtful debts. 4) No.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits?	1) There are no specific tax relief rules for items such as interest income. All interest income is taxable on an accrual basis for all sectors, including the financial sector. 2) Thin capitalisation rules do not apply to banks. Other sectors must comply with thin capitalisation rules that restrict deductibility of interest on loans from creditors other than credit institutions if certain criteria are not met. The debt-equity ratio which should be maintained for the companies in non-financial sector is 4:1.

Latvia	
3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	3) No. 4) Yes, Latvian branches of foreign banks may deduct for CIT purposes a notional interest equal to LIBOR + 3% irrespective of the actually agreed interest rate on loans granted by the head office to its Latvian branch. This is only applicable to branches, not subsidiaries. In other sectors, branches may not deduct any interest on the loans from head office, only actual interest on loans from third parties (also if sourced through the head office) is tax deductible.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Interest is treated as tax deductible expense for banks. No thin cap rules are applicable to the financial sector companies. Dividends paid are not taxable by CIT as paid out from after tax profits. 2) Interest received is taxable at the standard CIT rate of 15%. Dividends received from EU companies are exempt from tax in Latvia. Dividends received from low tax jurisdictions and tax exempt companies are taxable in Latvia. 3) See the answer to Q5. 4) Interest is taxed on accrued basis for all companies including financial sector companies. 5) No differences in respect of dividends. Interest payments made by Latvian banks to non-resident related parties are subject to 5% WHT. In other sectors: generally, interest payments to related non-resident parties are subject to 10% WHT, and only interest payments to related EU companies (as defined by the CIT law) are subject to 5% WHT and certain administrative procedure must be followed.

Latvia	
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Realised gains/ losses on fixed assets are taxable/ deductible, while unrealised gains/ losses on fixed assets are non-taxable/ non-deductible for all sectors, including in the financial sector.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) Tax treatment follows accounting treatment, i.e., usually, such discounts are accounted as interest income under IFRS (and under Latvian GAAP) and, as a consequence, are taxable on accrued basis. 2) Realised gains on sale of EU/ EEA public securities are non-taxable, while realised losses on sale of such securities are non-deductible. Gains on sale of other securities are taxable, while losses on sale of such other securities may be carried forward for 8 years and set against future gains from sale of such other securities. Gains / losses from other assets are taxable/ deductible when realised. These general rules apply to all sectors, including the financial sector.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i)-(iii) Banks may not deduct general provisions for bad and doubtful debts. In this respect there is no difference with other sectors. (iv) No. (v) Unlike other sectors, banks are allowed to deduct specific provisions for bad and doubtful debts. A specific provision is a provision created against specific debtor balance, as opposed to general provision created on a pool of debtor balances. (vi) Specific provisions for shares and other non-fixed income securities, investments into shares of related companies, own shares, losses due to theft, fixed assets and loans issued to persons in low tax (off-shore) jurisdictions (list published

Latvia	
	by the Cabinet of Ministers) cannot be deducted for CIT purposes.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Yes, employee stock option plans are deductible - no difference with other sectors.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1. Banks keep their accounting records and prepare annual accounts based on IFRS. 2. No, except in respect to the deductibility of interest on loans granted by a foreign bank (head office) to its Latvian branch (see under A.2 (4)).
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No information

Lithuania	
A. General tax regime applicable to banks	
General comments	
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The applicable corporate income tax (CIT) rate to banks is the same as other business entities and equals to 15%. No other surcharges or local taxes are applied. There is no bank levy or Financial Activities Tax applicable in Lithuania. There are no pending proposals in this respect as well. 2) No. 3) The rules to compute the corporate income tax base by banks generally do not differ from those applied to other sectors. However, according to Article 27 of the Law on CIT, only credit institutions (including banks) are allowed to deduct specific provisions for doubtful loans. For details see answers to question A.6. 4) No.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of	1) Generally, no. However, interest on securities issued by Lithuanian Government, Lithuanian Municipalities, international institutions where Lithuania is a member are exempted, if the agreement on issuance of securities was concluded before 1 January 2003. 2) No. No specific anti-avoidance rules or rules to avoid offshoring of profits are applicable to banks. General anti-avoidance rules are applicable. Lithuanian anti-avoidance rules are the following: Lithuanian Tax Authorities are empowered to apply the "substance over form" principle and to tax any transaction according to its substance if the form or structure

banks?	of this transaction is chosen solely for tax purposes. ▪ According to the transfer pricing rules, all transactions between related parties should be performed at fair market prices. ▪ Lithuanian Thin Cap rules apply in respect to borrowings from related parties as well as to borrowings guaranteed by related parties. The debt to equity ratio is 4:1. These provisions do not apply if a Lithuanian company can prove that the same loan under the same conditions would have been granted by non-related party. ▪ Payments made by a Lithuanian entity or permanent establishment (except for payments made in respect of an acquisition of assets where the Lithuanian entity or permanent establishment can provide documents evidencing the entry of such assets into the state) to foreign entities registered or otherwise organised in black-listed (target) territories shall be substantiated with evidence that: (i) such payments are related to the usual activities of the paying and receiving entity; (ii) the receiving foreign entity controls the assets needed to perform such usual activities; (iii) there is a link between the payment and the economically feasible operation. 3) No. 4) No.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT?	1) No specific rules related to interest and dividends paid are applied to banks. If interest expenses are related to earning taxable income, deriving economic benefit and are established at arm's length, these expenses are deducted based on the accrual

Lithuania	
2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	principle. Lithuanian thin capitalization rules apply to banks as well as to other business entities. However, they do not apply to financial institutions providing financial lease (leasing) services. The thin capitalization rules apply in respect to borrowings from related parties as well as borrowings guaranteed by related parties. The debt to equity ratio is 4:1. These provisions do not apply if a Lithuanian entity can prove that the same loan under the same conditions would have been granted by non-related party. Furthermore, interest which is established based on profits, income or any similar criteria as well as interest which are related to interest bearing liabilities with a right to convert the interest into part of the profits of Lithuanian entity cannot be deducted for CIT purposes. Dividends paid are not included into income statement, therefore, are non-deductible expenses. 2) No specific rules related to interest and dividends received are applied to banks. Interests received (interest income) should be established at arm's length and are taxed based on the accrual principle. Dividends received by a Lithuanian bank (as well as by other business entities) for the shares held in Lithuanian entities shall be subject to 15% CIT. However, dividends received by Lithuanian bank (as well as by other business entities) where the recipient has held at least 10% of voting shares (ownership interests) for a continuous period of at least 12 successive months including the moment of distribution are tax exempted. Dividends received by Lithuanian banks (as well as by other business entities) from foreign entities are not subject to taxation in Lithuania if a foreign company is registered in a country of European Economic Area and these dividends are

Lithuania	
	distributed from profit that was subject to CIT or similar tax. No minimum shareholding percentage or holding period is applied. 3) Generally, dividends paid are subject to withholding tax at 15%. However, dividends paid by Lithuanian banks (as well as by other business entities) where the recipient has held at least 10% of voting shares (ownership interests) for a continuous period of at least 12 successive months including at the moment of distribution are not subject to withholding tax. This relief is not applied if the recipient is registered or otherwise organised in an offshore jurisdiction included in the specific Ministry of Finance blacklist. 4) For CIT purposes interest (interest income) on advances and on securities of all kind is recognised based on the accrual principle. Mark-to-market is not applied. 5) According to the Law on CIT, as from 1 January 2010 interest paid from Lithuanian entities as well as from Lithuanian branches of foreign entities to foreign entities established in the European Economic Area and in countries with which Lithuania has a DTT are not subject to WHT in Lithuania.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Banks' gains and losses on fixed assets are treated in the same way as other taxable entities' gains and losses on fixed assets. The gains on fixed assets are considered as ordinary business income and are subject to 15% CIT. The losses on fixed assets are treated as allowable deductions provided that fixed assets were sold at arm's length price.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments	For CIT purposes, following the substance over form principle, the discounts on government bills, trade bills and other like instruments are treated as interest income. Therefore, income from these instruments is recognised on time proportion basis

Lithuania	
treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	during the maturity term, i.e. based on the accrual principle. *Unrealised gains (income)/losses (expenses).*The gains recognised from revaluation of assets held for trading purposes except for derivatives held for hedging purposes are non-taxable and losses are non-deductible. Specific tax rules apply for revaluation of derivatives held for hedging purposes. The gains recognised from revaluation of derivatives held for hedging purposes are taxable and losses are deductible. *Realised gains (income)/losses (expenses)*. Gains/losses from realised transactions (i.e. recognised upon sale or the maturity of a contract) should be recognised based on an accrual principle and be subject to general tax regime: gains – taxable, losses – deductible provided that they are related to earning taxable income and deriving economic benefits of a bank (or a company).
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i) Not applicable (see the answer to part (ii) of this question). (ii) General provisions (i.e. provisions for entire portfolio of doubtful assets) are made at discretion of credit institutions. Loan value impairment may be assessed per group of similar loans. The bank should provide proof that the distinguished group of similar loans comprises loans bearing similar risk features. Groups of similar loans shall be formed having regard to loan characteristics (loan type, amount, collateral, defaulted maturity, loss previously incurred on similar loans (historical data, etc.) and the borrower (borrower's type), influencing the calculation of the loan value impairment. Value impairment loss amount per group of similar loans shall be calculated as the difference between the carrying amount of the group of similar loans and estimated future cash flows calculated in observance of the previously incurred loss on similar loans (historical data). For the purpose of discounting future cash flows the weighted

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	average of the original effective interest rate may be used. If it is possible to identify within the group of similar loans any particular loan, the value of which has impaired, such loan should be removed from the group of similar loans and assessed individually. According to Article 27 of the Law on CIT, general provisions (i.e. provisions for entire portfolio of doubtful assets) made by credit institutions are non-deductible. (iii)Not applicable. (iv) Yes, but only to extent allowed by the rules of the Bank of Lithuania (Minimum Requirements on Loan Valuation as established by Bank of Lithuania, Decree No. 114, 28 July 2005). These rules state: ▪ When recognising a loan for the first time, it should be assessed at fair value of consideration paid (transaction cost). ▪ If after initial loan recognition loss events are identified, such loans should be subject to individual assessment. ▪ The value impairment loss amount of loans assessed individually shall be calculated as the difference between the carrying amount of the loan and current value of estimated future cash flows discounted at the original actual interest rate of such loan. ▪ The bank should assess probability of loss events at least once a quarter. ▪ Upon existence of at least one objective evidence of impairment in the value of a loan, the bank must assess such impairment immediately. ▪ Loan value impairment may be calculated as one or several amounts ▪ ***The impairment (increase) in the value of a loan should be disclosed in the***

Lithuania	
	account of specific provisions. (For details please refer to the attached document "Minimum Requirements on Loan Valuation as established by Bank of Lithuania, Decree No. 114, 28 July 2005"). (v) According to Article 27 of the Law on CIT, specific provisions (i.e. provisions for a particular doubtful loan) made by credit institutions are deductible. (vi) No. Deductibility is allowed to the extent of the rules of the Bank of Lithuania (Minimum Requirements on Loan Valuation as established by Bank of Lithuania, Decree No. 114, 28 July 2005).
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	The issue of deductibility of expenses related to stock options is not explicitly described in Lithuanian Law on CIT, and therefore, has not been common in practice in Lithuania. Generally, employees' stock options plan should be non-deductible. However, we believe that it may be treated as deductible for CIT purposes since said amounts would be recognized as benefits-in-kind (employment related income) and be subject to Personal Income Tax (PIT) and social security contributions. Please note that deduction can only be taken if costs are actually incurred and taxed as mentioned above.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to	1) From accounting practice perspective, there is a mandatory requirement for banks to apply IFRS as adopted by the EU. Therefore, accounting discretion can only be used to the extent it is allowed under IFRS. 2) There are no differences in the provisions applicable to subsidiaries. From the

Lithuania	
subsidiaries and branches of non-domestic banks?	regulatory compliance perspective, there are significantly less mandatory regulatory compliance requirements for branches of non-domestic banks in comparison with domestic banks (which may be subsidiaries of non-domestic banks). For example, a branch of non-domestic bank should only comply with liquidity ratio established by the Bank of Lithuania. Other mandatory ratios are not applied.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No

Luxembourg	
A. General tax regime applicable to banks	
General comments	Our Luxembourg tax comments are made assuming that banks run their accounts in LuxGAAP. We do not refer to IFRS accounting as the tax consequences of adopting IFRS standards is not yet clear (a draft bill is in discussion in this respect). However, based on the current draft, the same tax principles should remain applicable. The tax treatment for banks is the standard one with few differences. For sake of completeness, we answered all the questions and we indicated when the tax treatment described is applicable only to banks or is applicable to any taxpayer. There are currently neither bank levies nor financial activities tax currently applicable or envisaged in (pending) proposals in Luxembourg.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The applicable Corporate Income Tax rate ("CIT") is 21% on which a 5% solidarity surcharge is computed, so that the total CIT is 22.05% as from 01.01.2011. Banks, as any corporations, are also subject to Municipal Business Tax ("MBT"), which rate varies between 6.75% and approx. 9% depending on the cities. For banks established in Luxembourg city, the combined CIT/MBT rate is 28.80%. Banks, as any corporations, are also subject to a yearly Net Wealth Tax ("NWT") which is computed on the net assets value (with some tax adjustments) of the bank each year at a rate of 0.5%. 2) There is no special tax rate applicable to banks except for the very specific case of credit cooperative companies ("CCC") which sole activity is to collect proceeds from its members to provide financing to them (article 174 (4) of the Luxembourg Income Tax Law, "LITL"). CCC may benefit from a reduced CIT rate (i.e. 7% instead of 21%) whereby the combined CIT/MBT rate is approx. 14.1% for Luxembourg city. If the conditions are not met however, the standard rate is applicable. In practice,

Luxembourg	
	such reduced rate is more theoretical as generally the few CCC (2 out of 146 banks as at 28.02.2011) in Luxembourg do not meet the conditions for applying the reduced rate. 3) As for any taxpayer in Luxembourg, the tax treatment for banks generally follow the accounting treatment except if otherwise provided for by the tax legislation (article 40 LITL). Compared to other sectors, banks are entitled, according to the banking law, to book specific provisions in their accounts (see section A6) which are tax deductible to a certain extent. However, this is only an application of the general rules (i.e. tax follows accounting). Regardless of the currency of the capital of the bank and/or the accounting currency, the taxable profit must in principle be computed in EUR and tax returns should be filled in accordingly. The taxable profit corresponds to the difference between the net asset value of the bank expressed in EUR at the beginning of the financial year and at the end of the financial year. The evolution of exchange rates has, therefore, an impact on the tax profit. To mitigate this artificial effect, banks are entitled to benefit from a roll-over relief to neutralize this "artificial" forex under conditions (article 54bis LITL). This relief is only temporary and should normally be taxed at the latest at the time of liquidation of the company (except if a specific exemption could apply). Please note that this provision is also applicable to insurance and reinsurance undertakings as well as to any company mainly active in the trade of financial and currency assets. All tax incentives (investment tax credit, tax sparing credit granted under a double tax treaty …) or tax exemptions/reliefs applicable to banks are also applicable to other taxpayers. 4) There are no specific turnover taxes on gross interest and/or other income of banks

Luxembourg	
	in Luxembourg.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) No. 2) No. CFC rules derive from an administrative practice applicable to any taxpayer according to which, for instance, the financing of participations should normally comply with a 85-15 debt-to-equity ratio in case of related party financing. Thin capitalization rules do not apply only to the financial sector. 3) No. 4) No.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad)	1) As for any taxpayer, interest payments made by banks are fully tax deductible for CIT/MBT purposes except if they are in direct economic link with a tax exempt asset/income. In addition, in case such payments do not respect thin capitalization or transfer pricing rules for instance, such payments may not be tax deductible. Thin capitalization rules do not apply only to the financial sector Dividends are not tax deductible for CIT/MBT purposes. This is the standard tax treatment applicable to any taxpayer. 2) Interest payments received are fully taxable for CIT/MBT purposes. Dividends are fully taxable for CIT/MBT purposes except if they qualify ***(i)*** for the participation exemption regime in Luxembourg (article 166 LITL) or ***(ii)*** for the half exemption (article 115.15a LITL). Both exemptions are available to any qualifying

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pays interest (on a debt which is borne by the permanent establishment) to a third party?	taxpayers in Luxembourg. The exemption granted under article 166 LITL is a 100% exemption if the following requirements are met: (i) dividends are distributed by a collective entity listed in the EU Parent-Subsidiary Directive or by a non-resident joint-stock company fully liable (in its State of residence) to a tax corresponding to the Luxembourg CIT; (ii) at the time when the income is made available, the taxpayer hold (or undertakes to hold) directly a participation in the share capital of the subsidiary of 10% (or EUR 1.2m acquisition price) for an uninterrupted period of at least 12 months. Related expenses incurred during the year in which a dividend is received may only be deducted insofar as they exceed the exempt dividend for the year in question. The conditions to be met for the 50% exemption are those mentioned in ***(i)*** above. Besides, expenses in economic link with tax exempt income are not tax deductible. 3) Dividends on shares are in principle subject to a 15% withholding tax in Luxembourg except if they qualify for the participation exemption or if a reduction applies under the relevant double tax treaty. This is the standard withholding tax rate applicable to any Luxembourg taxpayer. The domestic withholding tax exemption will apply only if a 10% participation in the share capital (or EUR 1.2m acquisition price) of the distributing company is held (or commitment to hold) for an uninterrupted period of 12 months and the dividend is paid to a collective entity listed in the EU Parent-Subsidiary Directive or member of the EEA agreement and fully liable to a tax corresponding to Luxembourg CIT, a joint.-stock company tax resident in a country with which Luxembourg signed a double tax treaty and which is fully liable to a tax corresponding to the Luxembourg CIT, a joint-stock company tax resident in Switzerland and subject to corporate taxes

Luxembourg	
	in Switzerland without being exempt. 4) In principle, the following methods are used for valuation of investments: ***(i)*** acquisition price, ***(ii)*** lower of cost or market value and ***(iii)*** mark-to-market. For interest, generally the accrual method is used. 5) There is no withholding tax on interest under Luxembourg domestic law (except if the debt has very specific features).
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Gains and losses on fixed assets are respectively fully taxable or tax deductible. Nevertheless, certain assets may qualify, under conditions, for a roll-over relief (temporary neutralization) in case proceeds from the sale are reinvested in another qualifying asset (article 54 LITL). The capital gain will be taxed at least in case of disposal of the assets in which proceeds were reinvested. This roll-over relief is available for any taxpayer in Luxembourg and not only banks. Moreover, participations held in qualifying companies may benefit from a tax exemption on the capital gain realized upon disposal according to the participation exemption regime (same conditions as for article 166 LITL except that the acquisition price is EUR 6m instead of EUR 1.2m and recapture rules are not limited to the year in which the tax exempt gain is realized). Capital losses are fully tax deductible.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes?	1) Discounts on bills are fully taxable in Luxembourg. Generally, there will be a time difference on the recognition of the gain due to the discount between accounting and tax. From an accounting perspective, the discount will be recognized during the lifespan of the instrument (*prorata temporis*) whereas for tax purposes it will be only recognized at maturity (application of valuation tax rules, article 23 LITL). This tax

Luxembourg	
2. How are assets held for trading purposes treated for tax purposes?	treatment is applicable to any taxpayer in Luxembourg. 2) There are no specific rules for assets held for trading purposes. Generally, as they do not meet any conditions for tax exemptions, their capital gains will be taxable and capital losses will be tax deductible. Interest received and dividends received before disposal should also be fully taxable.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	As the tax treatment follows the accounting treatment, provisions for doubtful debts on advances and loans are in principle tax deductible if recognized for accounting purposes. The main conditions for a provision to be tax deductible are to be linked to the business of the company and to be economically justified. A distinction should be however be made between value adjustments booked according to article 58 or 62 of the amended Law of June 17, 1992. Value adjustments made under article 58 generally comply with valuation rules for tax purposes (i.e. valuation at acquisition cost or lower market value) and are in principle tax deductible. On the other hand, value adjustments according to article 62 are only made to take into account the inherent banking risk for certain type of assets and are in principle not tax deductible. Risks and charges provisions booked according to article 31 of the amended Law of 17 June 1992 are in principle tax deductible as the loss is clearly identified and either likely or certain to occur but uncertain as to the amount or to the date. Besides, country risk provisions reflecting the temporary risk of recovery due to economic/political situation of the country of the debtor are also tax deductible. A lump-sum provision for risk-weighted assets could also be booked by the banks and is tax deductible if it meets certain conditions (i.e. limitation to 1.25% of the qualifying risk weighted assets) according to the Instructions form the Director of the Luxembourg Tax Authorities dated 16 December 1997.

Luxembourg	
	Finally, the AGDL ("Association pour la Garantie des Dépôts Luxembourg") provision booked is also tax deductible according to article 167 (5) LITL and the Grand Ducal Decree dated 21 December 1991.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Yes and for all companies (not only banks).
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Please refer to our comments on question A.6 notably on provisions according to article 31, 58 and 62 of the amended law dated 17 June 1992 2) No.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No.

Malta	
A. General tax regime applicable to banks	
General comments	There are no special taxes in Malta for banks, such as bank levies or Financial Activities tax. Based on our knowledge, we are not aware that there are pending proposals in this respect.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The Maltese normal corporate income tax rate is a flat rate of 35% chargeable on the taxable profits (including certain capital gains) of the company. There are no surcharges or other local taxes charged on income/ gains. 2) Banks are subject to the normal 35% tax rate as set out in 1 above. Furthermore, in general, banks are taxed in the normal manner as any other company. Naturally the Maltese income tax treatment of a bank (e.g. determination of taxable income, etc.) takes into consideration the particular trading activities/ characteristics of banks, however such an approach also applies in the case of any other trading company. 3) There are no specific tax rules to determine the corporate tax base for a bank. As outlined in point 2 above, the fact that a bank would be carrying out trading activities will be taken into consideration when computing the taxable income, but this is also the case for other trading companies which are not banks. 4) In respect of turnover taxes, Malta imposes VAT on the basis of EU VAT Directives with the standard VAT rate being 18%. However the Maltese VAT Act provides for an exemption without credit in the case of "credit, banking and other services", subject to certain conditions and also specific exclusions. This exemption includes inter alia "the granting and the negotiation of credit and the management of credit by the person granting it", i.e. interest income of banks should in general be covered by this VAT exemption without credit. Hence in general banks should not be required to charge Maltese VAT in respect of services falling within the terms of the above-mentioned exemption and should also

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	in general not be allowed to recover VAT incurred (the latter may be subject to certain exceptions, e.g. if the customers of the bank are established outside the European Union). If a bank provides any service/s which is/ are not covered by the aforesaid exemption without credit, then the bank should be required to charge Maltese VAT on such service/s (subject that the place of supply is in Malta and that the particular supply is VATable) and should also be in a position to recover that part of the VAT incurred (if any) attributable to such service/s.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1)Certain items of non-Maltese source income (including, among others, profits of certain banks resulting from investments, assets or liabilities situated outside Malta - this provision is not limited to banks but applies in respect of a variety of foreign-related income sources as defined in the Maltese Income Tax Act which may be received by any company, irrespective of the activities carried on thereby) may, subject to the satisfaction of certain statutory conditions, qualify for a unilateral relief mechanism referred to as the Flat Rate Foreign Tax Credit (FRFTC). As stated above, the FRFTC is available to any company (i.e. not only to banks) in respect of income earned thereby which falls within the purport of the particular provision. 2) Maltese income tax law does not provide for CFC rules nor thin capitalisation rules. There are a few rather general anti-avoidance provisions in Maltese tax law but these do not draw a distinction between banks and other companies. There are no specific rules to avoid offshoring of profits but the above-mentioned general anti-avoidance provisions in Maltese tax law may possibly be invoked for this purpose by the Maltese Revenue – again there is no distinction in this respect between banks and other companies. 3) In general, Malta's double taxation agreements define "company" as any body corporate or any entity which is treated as a body corporate for tax purposes, and such definition should therefore include a bank where the bank is a body corporate

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	for Maltese tax purposes (naturally we have not made any comprehensive review of Malta's treaties to establish this point and thus this comment is based on general principles). 4) No.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Interest paid by a Maltese bank: Interest paid by a Maltese bank in respect of a deposit of money (except for bearer accounts) or interest payable in respect of a public issue, may be taxed at a favourable rate of 15% (through a withholding tax system) in the hands of Maltese-resident recipients as specifically defined in the Maltese Income Tax Act. This tax rate of 15% does not apply only in respect of payment of interest by Maltese banks but applies also in a variety of cases (also not including banks) specifically set out in the law. A Maltese-resident investor receiving the said interest may opt to be taxed in the normal manner, i.e. receive the interest without the deduction of the said 15% withholding tax. Interest paid to non-Maltese-residents should be exempt from Maltese income tax subject to the satisfaction of certain statutory conditions. The interest incurred by the bank should be tax deductible in the hands of the bank if such interest is wholly and exclusively incurred in the production of the bank's income. In the case of banks, interest expenses should normally be tax deductible on the basis that such interest expense would be incurred in the production of the interest income of the bank. Naturally each specific case may need to be considered on its own merits. Dividend paid by a Maltese bank: There are no different rules applicable to dividend distributions from banks, i.e. the rules are the same as any other company in this respect. In brief, there should be no further tax on a distribution of taxed profits, whilst a distribution of untaxed profits

Malta	
	should be subject to a withholding tax of 15% where the recipient of the dividend is (a) a Maltese-resident person other than a company, or (b) a non-resident person who is owned and controlled by, directly or indirectly, or acts on behalf of an individual who is ordinarily resident and domiciled in Malta. Dividends paid by a bank should not be tax deductible in the hands of the bank on the basis that dividends are an appropriation of income (this concept applies across the board i.e. not just for banks). 2) Interest received by a Maltese bank: Interest received by a Maltese bank is normally treated for tax purposes as part of its trading income (since this should be the trading activity of a bank) and hence the net interest income, i.e. after allowing for any tax-deductible expenses, should be charged to Maltese income tax. In the case of interest income derived from a non-Maltese source, such interest may qualify for double taxation relief under any applicable form of double taxation relief contemplated under Maltese tax law. Dividends received by a Maltese bank: Dividends received by a Maltese bank should be treated for Maltese income tax purposes in the same manner as any other Maltese company receiving dividends. In brief, there should be no further income tax payable on the receipt of a dividend from another Maltese company. Dividend income from holdings in foreign companies or foreign limited partnerships may qualify for the Maltese participation exemption subject to the satisfaction of a number of statutory conditions. The Maltese participation exemption on dividends/ gains may also apply in respect of trading assets. Naturally for the Maltese participation exemption to apply certain statutory conditions would have to be satisfied but the fact that the shares producing the dividend may be trading assets does not in itself disqualify the possibility for the Maltese participation exemption.

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	In Malta, banks may still qualify for a participation exemption on dividends even though the shares may be regarded as trading assets or portfolio shares. Naturally the participation exemption is still subject to the satisfaction of certain statutory conditions. 3) In general there is no withholding tax under Maltese tax law in respect of distributions of dividends from one Maltese company to another Maltese company (including where the recipient is a bank). In the local context (i.e. a distribution from a Maltese company to another), there may only be a withholding tax where the income would have been taxed at the level of the distributing company at a lower tax rate simply by reason of the fact that a different tax rate applied at the time that the profits were generated by the underlying company. In respect of dividends receivable by a Maltese bank from foreign shares, one would naturally need to verify the tax position of the foreign country involved in order to ascertain whether any foreign withholding tax applies in respect of the dividend. The above tax treatment is common to both banks and any other Maltese company. Malta does not impose a withholding tax on distributions to non-residents subject that such non-residents are not owned and controlled by, directly or indirectly, nor act on behalf of any Maltese-domiciled and ordinarily resident individuals. 4) In the context of banks, i.e. where the interest income should normally be treated as trading income of the bank, such interest income should in general be taxed on the accrual basis. Having said this, the specific circumstances of each case would have to be taken into consideration and if, for example, for accounting purposes the interest income in any particular situation is not accounted for under the accruals basis then one may possibly need to consider further the Maltese income tax

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	treatment thereof. It should be highly unlikely that interest income is not treated as trading income for tax purposes in the case of a bank given that interest is typically generated in the course of the bank's trading activity. In the unlikely scenario that the interest is not part of the trading income of a bank (for tax purposes) in a particular set of circumstances, then the interest may possibly be taxable on a receipt basis. Given that there is no specific rule in this respect and the normal approach should be to tax the interest on the basis of the accounting disclosure, if such a situation were to arise it would be advisable that the particular case is analysed and discussed on its own merits. 5) The payment of interest to a non-resident should not be subject to Maltese withholding tax subject to the satisfaction of certain statutory conditions, i.e. in brief that the debt claim from which the interest arises is not effectively connected to a Maltese permanent establishment of the non-resident recipient, and the beneficial owner of the interest is a person not resident in Malta and such person is not owned and controlled by, directly or indirectly, nor acts on behalf of an individual or individuals who are ordinarily resident and domiciled in Malta. If the recipient of the interest is a Maltese resident, there may be the requirement under Maltese tax law for a withholding tax of 35% to be applied on the payment of the interest if such interest arises from a debenture or from any other loan advanced to a company for a capital purpose (excluding interest on customer's deposits and current accounts). Similar withholding tax considerations to those set out above should in general also apply if the Maltese head office were to pay interest in respect of a debt claim borne by a non-Maltese permanent establishment of the said head office.

Malta	
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	We understand that this question is referring to gains/ losses arising on the disposal of fixed assets by a bank. There are no special tax rules in Malta applicable for banks in this respect. In brief, if capital allowances (tax depreciation) were claimed on the particular fixed asset then, in general, upon the disposal (or if destroyed or put out of use) of such fixed asset the transferor should be required to prepare a balancing statement which would either result in an allowance (where the disposal value is less than the tax written down value) or a taxable charge (where the disposal value is higher than the tax written down value). The accounting gain/ loss should be reversed for tax purposes. In the case where the particular fixed asset is caught by the Maltese income tax provisions regulating capital gains (e.g. transfer of immovable property), the transferor should be required to prepare a tax computation showing the capital gain/ loss in terms of the specific tax provisions (this computation would be over and above the aforesaid balancing statement depending on whether capital allowances were claimed on the asset). The said capital gain should be taxable together with the other items of income whilst a capital loss (i.e. a loss derived from a capital asset and not from a trading asset) can only be tax deductible against a capital gain (where any deduction is actually allowed by law). The capital loss may be carried forward to future years indefinitely and absorbed against future capital gains (but not against trading gains/ profits). Hence the fact that there is no other capital gain during the particular year where a capital loss is realised should not mean that the capital loss is lost forever. Capital losses can be carried forward indefinitely to future years and absorbed against future capital gains.

Malta	
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) Discounts payable by the Government of Malta or by any agency thereof, discounts payable by a corporation or authority established by law, or discounts payable in respect of a public issue may be subject to a final withholding tax rate of 15%. However certain recipients of such income are excluded from benefitting from the said withholding tax rate and one of such exclusions applies where the recipient is a Maltese licensed bank. Hence given the non-applicability of the aforesaid 15% withholding tax in the case of a Maltese bank receiving such income and also the absence of any specific tax exemption, such discounts should in general be subject to tax in the hands of a Maltese bank at the normal corporate tax rate of 35%. 2) A bank is generally treated as carrying on a trading activity and consequently the income generated thereby is normally treated as trading income. In respect of assets which are held as trading assets by the bank, there are no special tax rules outlining the tax treatment thereof and hence trading income/ gains arising from such trading assets should in general be subject to tax in the normal manner. Naturally it would be advisable that each case would be analysed on its own merits so as to ascertain the precise Maltese income tax treatment in the particular circumstances. One point which may be noted is that if the assets are treated as trading assets for tax purposes then the capital gains provisions (taxation but also exemption provisions) should not be applicable in respect of gains arising from such assets. In other words, the provisions of the tax law regulating capital gains only apply in the case of "capital assets". If the particular asset is held as a trading asset then the capital gains provisions (both in respect of the taxing provisions and also in respect of any tax exemptions which may apply under such capital gains provisions) would not apply. Naturally any trading income arising therefrom should in general be taxable under the normal (i.e. not capital gains) tax provisions.

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F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	The general rule for tax deductibility under Maltese tax law is that an expense is tax-deductible to the extent to which such expense is wholly and exclusively incurred in the production of the income. Hence general or specific provisions/ provisions for doubtful debts should not satisfy this test and should not be tax-deductible for Maltese tax purposes. On the other hand, there is a specific rule (i.e. over and above the general rule set out above) which provides for the tax deductibility of bad debts subject to the satisfaction of certain conditions i.e. a tax deduction is provided in respect of "bad debts incurred in any trade, business, profession or vocation, proved to the satisfaction of the Commissioner to have become bad during the year immediately preceding the year of assessment notwithstanding that such bad debts were due and payable prior to the commencement of the said year …". A bad debt is a debt which has been recognised as unrecoverable. However in order for the bad debt to be tax deductible, it is not enough to be recorded as such in the financial statements but it has also to satisfy the conditions set out in the Maltese Revenue Guidelines on the subject. Hence subject that the bad debt on the advance/ loan arises from the trade/ business of the bank and subject that all the other statutory conditions would be satisfied, the bad debt arising on an advance/ loan should be tax- deductible on the basis of the above provision of the law. Furthermore the Maltese Revenue has issued Official Guidelines so as to provide guidance in respect of the tax deductibility of bad debts in respect of all taxpayers. These Guidelines primarily provide guidance to the taxpayer in respect of the parameters which the Revenue uses in determining that the bad debt should be treated as "bad" for tax purposes. Indeed a debt which is recognised as "bad" for accounting purposes may not necessarily be "bad" for tax purposes in that in the latter case the specific rules set out in the tax law and in the Revenue Guidelines

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	would have to be satisfied for the particular bad debt to be tax-deductible. (i) General provisions should not be tax-deductible. Thus there are no minimum requirements etc. for tax purposes in these respects. Regarding bad debts, the Revenue Guidelines provide inter alia that in the case that the total amount of bad debts during a particular year exceeds €4,658, then certain further information would need to be provided to the Maltese Revenue in order to be in a position to claim a tax deduction. (ii) General provisions should not be tax-deductible. (iii) General provisions should not be tax-deductible. (iv) Given that specific provisions should not be tax deductible there are no specific tax rules in their respect. (v) Specific provisions should not be tax deductible. (vi) Specific provisions should not be tax deductible.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	1) As outlined above, the general rule for tax deductibility under Maltese tax law is that the expense must be wholly and exclusively incurred in the production of the income. In the case of stock/ share options, tax deductibility should be subject to the aforesaid general rule for deductions. As the exercise of the share option should be treated for Maltese income tax purposes as a fringe benefit (part of the employment income) granted by the Maltese bank/ company to its employees as a reward for services rendered, such benefit should in general satisfy the said tax deductibility rule and on that basis should normally be tax-deductible in the hands of the employer.

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	Tax deductions for employee emolument expenses, including the fringe benefit arising on the exercise of a share option, are subject to the further condition (applicable generally, i.e. not just in the case of banks) that the respective emoluments have to be duly reported by the employer to the Maltese Revenue in terms of the Final Settlement System Rules. Failure on the part of the employer to properly report such fringe benefits (and within a specific period of time as specified in the law) results in a loss of the right to claim the tax deduction by the employer of such a fringe benefit provided to the employees.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Accounting principles in Malta require the adoption of IFRSs as adopted by the European Union. These requirements do not contemplate over or under valuation of capital for banks. Accordingly, if our interpretation of this question is correct, there seems to be no possibility for over/ under valuation of capital in the Maltese context. 2) We understand that this question is referring to the replies provided under parts A1 to A7 above. We also understand that the comparison being made in this question is between a non-Maltese bank owning a banking subsidiary in Malta and a non-Maltese bank holding a banking branch in Malta. Please come back to us if our above understanding is not correct. The Maltese subsidiary and the Maltese branch should be treated in a similar manner for Maltese income tax purposes and hence the replies provided under parts A1 to A7 above should in general apply to both a subsidiary and a branch.
I. Practices	
For all the above conditions is there any information as whether actual	We are not aware that actual practices in respect of the matters discussed above differ from the applicable legal provisions. Furthermore there are no Maltese Revenue Guidelines/ official practices in respect of most of the matters covered by

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practices may differ from legal provisions?	this Questionnaire and hence it is not possible to provide any meaningful reply to such a general question. Having said this, it is normal practice here in Malta, especially in cases where there are no specific Revenue Guidelines/ practices on the particular matters, that any tax issue which is not clearly tackled in the tax law would be clarified upfront in writing with the Maltese Revenue.

The Netherlands	
A. General tax regime applicable to banks	
General comments	There is no bank levy applicable or Financial Activities Tax applicable. At the moment there are also no (pending) proposals with respect to introducing a bank levy or otherwise in the Netherlands. Note that the Dutch Minister of Finance is a supporter of introducing a banking levy but only in case consensus of introducing such a levy is reached at EU level.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The statutory Dutch corporate income tax rate of 25% applies, with a step up of 20% on the first Euro 200,000 of taxable income. There should be no local Dutch taxes. 2) Banks cannot qualify for (or receive) a special tax rate. Entities active in other industries should in principle also not qualify for a special tax rate. 3) In principle not (see further below). 4) N/A
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of	1) N/A. Interest received is in principle fully subject to DCIT. 2) We do not have specific anti-avoidance rules that only apply to the financial sector. Note that anti-avoidance or (for example) thin-cap rules , also applicable to the financial services sector, can limit the deduction of interest (mainly intra-group transactions). In principle the thin cap rules are applicable to interbanking debts, however, the amount of non-deductible interest under the Dutch thin cap rules should only be limited to the extent that intercompany interest paid exceeds intercompany interest received. As set out above, under the Dutch thin cap rules the amount of non-deductible interest should only be limited to the extent that

The Netherlands	
banks?	intercompany interest paid exceeds intercompany interest received. Under circumstances the Dutch participation exemption (exemption of dividends and capital gains on shareholdings of 5% or more) may not apply to (foreign) shareholdings, for example if the entity is held as a passive investment and the entity is not sufficiently taxed or predominantly holds passive assets (direct or indirectly tested). This rule can be considered as (a kind of) CFC-rule. This rule is applied in the same way for FS players. 3) N/A. 4) In principle not. However, in the Netherlands banks have the option to make use of a special rule with respect to crediting foreign withholding tax. In the Netherlands, foreign withholding tax can only be credited on a net basis i.e. costs attributable to the foreign income have to be deducted from the foreign income which limits the tax payers credit basis. For example, if a Dutch entity is financed back-to-back the credit basis will be (maximum) the DCIT due over the interest received minus interest paid (the other limit is the tax withheld on the foreign income received). Under this special rule banks are, however, allowed to (short said) assume that its receivables are financed with approx. 10% equity, which could improve its position to credit foreign withholding tax in the Netherlands. In other words, in principle banks are sure that on 10 % of their interest income they can credit foreign WHT. However, some calculations have to be made to come up with the exact figure (see the attached document**).**
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT?	1) Interest In the Netherlands interest paid to third parties or to group companies should in principle be tax deductible. However, deduction of interest may be limited due to (for example) anti-avoidance rules, thin cap, or a requalification of a loan into

The Netherlands	
3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	equity. This is the same for FS and non FS sector. Dividend In the Netherlands dividends should not be tax deductible. 2) Interest In the Netherlands interest received should in principle be fully subject to tax. Dividend Dividends received should in principle be subject to DCIT unless the Dutch participation exemption applies. 3) Distributed dividends are in principle subject to 15% Dutch dividend withholding tax unless (for example) the Parent-Subsidiary applies or a lower withholding rate under a tax treaty. 4) Interest on advances should be attributed and taxed in the period to which the advance relates (matching principle). 5) In the Netherlands there should be no withholding tax on interest payments.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Gains and losses on fixed assets are in principle taxed /deductible.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments	1) Discount (for example, the difference between issue price and face value) due to difference in interest or is the bill distressed? The difference in value due to the lower interest rate or the bill being distressed should not be taxed at the moment of

The Netherlands	
treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	acquiring the bill but either during the remaining term of the bill or at maturity date (depends on the situation). 2) In principle these assets can be valued at book value or lower concern-value (lower concern-value refers to" lower going-concern value"). A gain on the assets should be taxed upon realisation of the profit.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	In principle bad debts can be written down for DCIT purposes. The asset can be valued at book value or the lower concern-value. (i) System for FS and non FS should be the same. (ii) The provision should in principle tax deductible (no specific limitation); (iii) There are different methods to calculate the provision – on a case by case basis for example or on an overall basis whereby based on experience a percentage of the loans and advances are assumed to be uncollectable.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Costs relating to employees stock option plans should not be deductible for DCIT purposes.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to	1) As well under IFRS as Dutch Gaap a Bank should in principle not be allowed to use accounting discretion to under/over-state the book value of capital; the assets in principle have to be valued at fair market value or amortised cost (if for example a bond is held to maturity).

The Netherlands	
subsidiaries and branches of non-domestic banks?	2) In principle not.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	N/A

Poland	
A. General tax regime applicable to banks	
General comments	There is no bank levy or Financial Activities Tax in Poland Currently, a draft of the law introducing levy on banks and certain other financial institutions has been proposed by the opposition party in the Parliament. Based on parliament structure, even if the law is ultimately passed, it is unlikely that the law takes the form presented in the draft.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The standard CIT rate is 19%. The same CIT rate generally applies to all taxpayers (including banks). There are no local income taxes. 2) No. 3) The rules of computing the tax base are generally the same for banks as for other legal entities. However, some important exceptions regarding specific costs and revenues may apply to banks. This includes: ▪ tax treatment of provisions for bad debts or write-offs of bad debts, ▪ revenues from expired bank accounts, ▪ securitisation of receivables, ▪ costs and revenues connected with financial restructuring under specific laws. 4) No.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest	1) There are no specific tax reliefs applicable to banks. 2) The anti-avoidance rules are the same for all tax payers. There are no special rules

Poland	
income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	regarding offshoring. 3) Generally, there are no exclusions specified for financial companies from DTTs. 4) Subsidiaries are subject to taxation on the general principles. Branches of foreign banks are generally subject to taxation on the same principles, with some exceptions regarding their non-resident status. The most important issue is the deductibility of interest paid by the branch to the head office. In this case the free capital analysis should be calculated based on the OECD guidelines.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) General rules apply. Interest paid is treated as tax deductible costs (cash basis). Dividends are paid out of net income. Therefore dividends paid are not tax deductible for the payer. 2) General rules apply. Interest received is treated as taxable revenue (cash basis). Dividends received from residents are taxed at a rate of 19% and are not aggregated with other revenues of the taxpayer (the tax is withheld by the tax remitter, i.e. the entity paying out the dividends). Dividends received from non-residents are generally considered revenues aggregated with other revenues of the taxpayer. The withholding tax paid abroad can be deducted. Some exemptions for dividends paid between related entities are applicable – in accordance with the EU law. 3) General rules apply. The dividends on shares are subject to 19% WHT, unless the relevant DTT or EU law provisions are applicable. 4) General rules apply. Interest is generally recognized on a cash basis when paid. However, discount interest is tax deductible costs for the issuer upon the redemption of the security. At the same time it constitutes tax revenue for the holder. 5) General rules apply. Interest paid to a recipient abroad is generally subject to 20%

Poland	
	WHT. If a foreign branch of a Polish bank pays interest on a debt which is borne by that branch there should not be a WHT obligation in Poland. The WHT may arise if Poland is the source of interest. In the case of a foreign PE that pays interest on debt connected with the activity of this PE, Poland should not be regarded as the source country, hence no WHT in Poland should arise.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	General rules apply to banks and the gain is subject to the general CIT rate (19%). There is no separate capital gains tax. As a rule, losses on fixed assets are tax deductible, identical rules apply to banks and other entities.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) Discounts on securities are tax deductible (for the issuer) and are recognised as revenues (for the holder) as a rule upon the redemption or sale of the security. Some doubts may arise regarding the tax treatment of accrued coupon interest purchased. It could be argued that the purchased coupon is deductible upon receiving the revenue from the first coupon, but it is also possible to argue that the cost is deductible upon the redemption or sale of the security. The market practice in this matter is not uniform. 2) General rules apply, i.e. any valuation is, as a rule, tax neutral and the tax result is calculated as the difference between the sale price and the expenses made on acquisition of the securities. Interest is taxed on cash basis. However, if the taxpayer (a financial or non-financial institution) has chosen the so-called "accounting method" of foreign exchange recognition for CIT purposes and valuation of foreign currency securities is treated as "FX differences" for the accounting purposes, then the valuation of these securities can be considered a revenue or a cost for tax

Poland	
	purposes as well.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i) Under the Polish accounting standards (PAS) banks are allowed to create a "general risk provision" equal to no more than 1,5% of all outstanding loans (excluding classified as lost) but no more than the amount transferred from the net income to the general risk fund. (ii) If the bank uses the PAS the formation of the general risk provision allows the bank to tax-deduct it as a tax cost. On the other hand the release of the general risk provision is taxable revenue. If the bank uses the International Accounting Standards (IAS) the IBNR provision is treated for CIT purposes in the same way within the PAS limit (see below). IBNR stands for "incurred but not reported", it is a general risk provision that banks may create under IAS. (iii) If the bank uses the International Accounting Standards (IAS) and it wishes to deduct IBNR provision for CIT purposes it has to calculate a "hypothetical" general risk provision as it would be calculated under PAS. The tax deduction is limited to the smaller amount: general risk provision under PAS or provision for non-documented credit risk under IAS. (iv) No. (v) ▪ Doubtful loans. The CIT Law refers to the accounting standards and allows a tax deduction equal to 25% of the amount of doubtful loans with no obligation by the bank to document the uncollectibility of bad debts. ▪ Loans classified as lost can be tax deductible in full amount. However, formal documentation must be provided (e.g. court order declaring bankruptcy, a non-recovery letter issued by the proper authority or a declaration by the bank that

Poland	
	the costs of recovery would be greater than the debt). ▪ Note, that some special (beneficial) regulations may apply to financial restructuring under specific laws. (vi) If the bank uses the International Accounting Standards (IAS) and it wishes to deduct the impairment losses on loans and guarantees, it can do it only within the limits regarding deductibility of provisions on doubtful loans and loans classified as lost, mentioned in section v.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	In principle, costs of employment (regardless of the way of their calculation, thus including costs resulting from stock option plan) along with the social security contributions are recognizable as tax deductible costs.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	The accounting practices do not allow banks to use accounting discretion to under/over-state the book of their equity value. Generally, the same rules apply also to subsidiaries and branches of foreign banks. Some slight differences might apply to the branches, as they are not considered tax residents.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No material differences between practices and legal provision exist. It is common practice of the taxpayers to obtain a binding ruling from the Polish tax authorities in any situation which is unclear or unregulated (unclear tax law provisions).

Portugal	
A. General tax regime applicable to banks	
General comments	
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) Tax rates are the same for banks and other companies: 25% CIT, plus 1,5% maximum local surtax, plus 2,5% for taxable income exceeding 2M€ (these additional 2.5% is not a local tax). Companies operating in the Madeira Region may benefit from a reduced rate, but this reduced rate cannot be applied to banks and other financial entities. 2) No. 3) Main differences relate to tax treatment of provisions/impairment, such as bad debts. Banks may under certain conditions deduct for tax purposes impairment on securities and assets received as reimbursement of credit in default, while other companies may not. 4) Additional contributions on the banking sector have been introduced for 2011. In 2011 the banking sector will be subject to a new contribution regime in addition to the standard tax rates. *Entities subject to the bank levy* ▪ Portuguese headquartered credit institutions; ▪ Portuguese subsidiaries of foreign credit institutions; and ▪ Branches in Portugal of foreign credit institutions, except EU residents. *Taxable base* Base I - Liabilities, which are defined as the set of elements accounted for in the

Portugal	
	balance sheet which represent liabilities towards third parties, irrespective of their form or nature. Excluded from the taxable base are, amongst others: ▪ Items that are accounted for as equity; ▪ Liabilities for defined benefit retirement plans; ▪ Provisions; ▪ Liabilities concerning revaluation of financial derivatives; ▪ Receipts related to deferred income, irrespective liabilities' operations; and ▪ Liabilities related with assets which were not accounted for in securitization's operations. The Order also clarifies that only the part of the bank deposit actually covered by the Deposits Guarantee Fund is excluded from the taxable base. Base II - The notional amount of off-balance sheet financial derivatives, excluding hedging derivatives and back to back derivatives. The taxable base is calculated by reference to annual average of the monthly balances of the qualifying items, as reflected in the accounts approved regarding the year to which the bank levy relates to. *Tax rates* The Order foresees: Base I – 0.05%

Portugal	
	Base II - 0.00015%
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) Interest received by banks are included in its taxable income and taxed at normal rates. However, while in other companies such interest is also subject to withholding tax, which is a payment on account of the final tax due, in case of banks an exemption of withholding tax applies. This means that the banks do not need to make this advanced payment on interest income. A specific exemption from taxation of interest earned by foreign credit institutions arising from loans granted to resident banks in Portugal. This exemption is solely applicable to interbank loans and not to intercompany loans. 2) No 3) No 4) Although not specific ruled by the tax law, it is commonly accepted that banking branches may deduct interest paid on loans (funding) received from the head-office, while for other companies' branches such deduction is not straightforward.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual	Note: The only difference to the normal tax regime is the withholding tax aspect referred by us in B. 2) Interest and dividends are included in the taxable income and subject to the standard rate. Under certain conditions, a participation exemption can be achieved for dividends. 3) As a general rule, it is subject to 21.5% WHT, but under certain conditions it can be exempt (example: participation exemption for dividends).

Portugal	
basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	4) As a general rule, it is on an accrual basis. 5) There is no WHT in case a foreign branch pays interest, to the extent that interest paid is a cost attributed to the foreign branch. Same regime for companies.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Gains or losses are included in the taxable income and taxed at the standard rate. A reinvestment relief of 50% on gains may be available, subject to certain conditions.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) The tax treatment follows the typical accounting treatment. The typical accounting treatment refers to the amortized cost. 2) The tax treatment follows the typical accounting treatment. The typical accounting treatment is the fair value through profit and loss accounts. The fair value is considered for tax purposes in case the financial instruments have an official price and, if the financial instrument is shareholdings, the participation does not exceed 5%
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions?	There are specific tax rules for provisions constituted by banks. General provisions are not tax deductible. Specific provisions are deductible according to the rules imposed by the Bank of Portugal (BoP). However, only the minimum limits imposed by the BoP are tax deductible. Limits imposed by the BoP depend on the aging of the bad debts and

Portugal	
(vi) Limitation on deductibility of specific provisions?	guarantees provided by the client. Companies may also deduct specific provisions for bad/doubtful debts that also depend on the aging, but are subject to different (and more severe) tax restrictions.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Yes
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) No 2) Branches and subsidiaries have normally the same tax treatment. One difference relates to contributions for the banking sector, because Branches of EU Banks are not liable to the contributions on the banking sector referred in A1, while subsidiaries are.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No

Romania	
A. General tax regime applicable to banks	
General comments	Our below answers cover the tax implications applicable to banks (including subsidiaries and branches of non-resident banks), while considering the tax legislation in force. We have not covered the tax implications applicable to the National Bank of Romania ("NBR"), whose activity and tax regime is regulated by specific legislation. We have not undertaken an analysis of the accounting treatment applied to banks when considering the questions raised. We have only indicated potential accounting implications where these were relevant for understanding the underlying tax treatment and as such our answers should not be viewed as an accounting advice.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) **<u>CIT / Profit tax</u>** The general 16% CIT rate is applicable to both companies acting in the financial sector (e.g. banks) as well as to companies active in the non-financial sector. Currently there is no bank levy or any similar tax applicable to the financial services sector. However, we are aware of a legislation initiative started by the Romanian Parliament in respect of the assessment of a "*solidarity tax*" on profits derived by financial institutions. As per the discussions surrounding this measure, it would be only a temporary one (e.g. 3 years) and the tax rate is proposed to be 2.5% on profits derived during a previous fiscal year (in addition to the 16% regular CIT). Note that considering the current status of the proposal, we do not expect for this initiative to take effect in the near future. **<u>Local taxes</u>** The local taxes provided by the Romanian Fiscal Code (e.g. building tax, land tax, tax

Romania	
	on means of transport etc) are also applicable to banks. There are cases where such taxes (e.g. quotas) applied by the local authorities in Bucharest are higher than those used by the local authorities in Romania outside the capital city (within a range). The building tax ranges between 0.25 % - 1.25% of the value of the building (or between 5% - 10% for buildings that have not been revalued in the last three years). Land tax is a lump sum per square metre and tax on means of transport is also a lump sum depending on capacity, etc. (there are some grids in respect of land tax and tax on means of transport). 2) Banks cannot apply for special tax regimes that may be available to other types of companies (e.g. micro-company regime which allows small companies to apply a tax on turnover instead of a tax on profits). There are no special tax regimes available for banks or tax surcharges for banks. Banks can only apply the regular corporate income tax system (with 16% corporate tax). 3) The Romanian Fiscal Code generally provides for the same rules for computing the profit tax base for banks and companies acting outside the financial sector (some differences have been however pointed out below). There are however some differences in respect to the profit tax payment systems: Banks apply an advance profit tax payment system with quarterly payments (in four equal instalments). The payment for one quarter is equal to ¼ of the profit tax liability due for the previous year, which is adjusted by the inflation rate. The inflation rate used is the one estimated once the initial budget is planned for the year when the advance payments are made. On the contrary, regular taxpayers pay profit tax on a quarterly basis, considering the effective results for each quarter. The advance payment system would be applicable to all entities (not only banks) starting with fiscal year 2012. 4) No

Romania	
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) No 2) There are no CFC rules under the Romanian tax legislation. There is only a general anti-abuse substance over form rule that applies to all taxpayers equally. There are thin cap rules, but these are not applicable to banks and financial institutions or to financing received from banks or financial institutions. There is also a "safe harbour" rule according to which the deductibility of interest expenses on loans provided by entities other than banks / financial institutions is capped at a specific interest rate (the rate depends on the currency of the loans). For loans denominated in foreign currency (e.g. EUR), the limit is set at an annual rate (i.e. currently of 6%), while for local currency loans the limit is set at the level communicated by the National Bank of Romania in the last month of the quarter for which profit tax is computed (i.e. for March 2011, this interest rate was set at 6.25%). 3) Investment funds set up as non-legal entities (e.g. pass-through) are exempt from tax but the participants are considered subject to tax. 4) Not specifically, but please refer to rules on provisions for banks vs. branches in question A6 below.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)?	1) Under the general deductibility rule set out in the Romanian Fiscal Code, expenses are tax deductible if they are incurred for the purpose of generating taxable revenues. Interest paid to/by banks is therefore generally tax deductible if loan proceeds are used for business purposes. Dividends are to be distributed out of net profits and are not tax deductible. 2) There are no differences in the tax treatment applicable to banks and entities acting

Romania	
4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	outside the financial sector: ▪ the income from interest is taxable for profit tax purposes; ▪ the income from dividends distributed by Romanian legal entities is taxed by means of withholding at the level of the payer of the dividend (unless there is a minimum participation of 10% and a 2-year holding, in which case no withholding tax applies); dividends received from EU residents are considered taxable income (unless there is a minimum participation of 10% 2-year holding, case in which case no withholding tax applies); dividends from non-EU residents are included in the taxable base for CIT. 3) There are no differences in the tax treatment applicable to banks and entities acting outside the financial sector: Dividends (either to residents or to non-residents) are generally subject to 16% WHT in Romania. Nil WHT may be applied under certain conditions (e.g. minimum holding percentage and minimum holding period under the EU Parent-Subsidiary Directive, dividends distributed to pension funds etc) or reduced WHT rate (under double tax treaties). Please note that in case dividends are declared payable but not yet distributed, the WHT will still be due by 25th January of the following year. 4) The Romanian accounting system is based on the accrual principle in respect of interest expenses and revenues. 5) Under the Romanian Fiscal Code, interest payments made to non-resident companies by Romanian legal entities are subject to 16% domestic WHT. Generally, based on the “source” principle, income derived by non-residents from Romania is subject to domestic WHT. The Romanian tax law states that interest is subject to WHT if paid by a Romanian resident. In your specific case, as the branch is not a separate legal entity and is part of its head office, one may interpret that such a payment falls under the general rule of

Romania	
	income subject to WHT in Romania (being paid by a resident). However, we note that the Romanian Fiscal Code provides that interest borne by a Romanian permanent establishment and paid to a non-resident should be subject to WHT in Romania (sourced in Romania). Interpreting this provision per a contrario, there may be arguments to support that the interest paid by a foreign branch of a Romanian entity would not be subject to WHT in Romania. Given the two possible interpretations and the fact that the law is not very clear in this regard, we would recommend obtaining clarification from the tax authorities.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	There are no differences in the tax treatment applicable to banks and entities acting outside the financial sector- namely gains and losses on fixed assets are treated as taxable, respectively deductible for profit tax purposes. There is no basket taxation (e.g. losses on fixed assets can be offset against regular profits and vice-versa).
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) There are no differences in the tax treatment applicable to banks and entities acting outside the financial sector. Discounts are considered as taxable income for profit tax purposes. 2) From an accounting perspective, held for trading *("HFT")* instruments are registered at market value. Such instruments are marked-to-market and the differences generated are included in the profit and loss ("P&L") accounts (i.e. income/expenses). From a tax perspective, the following rules should be observed (applicable to all taxpayers): ▪ the favourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-taxable for profit tax purposes. Such differences become taxable upon realisation, e.g. sale of the financial assets.

Romania	
	▪ the unfavourable differences from revaluation of participation titles (e.g. shares) and bonds issued on long-term are non-deductible for profit tax purposes. Such differences become deductible upon realisation, e.g. sale of the financial assets. In conclusion, the tax treatment of the revaluation of HFT instruments mainly depends on the nature of such instruments (e.g. bonds issued on long term *versus* short term) and whether the differences are realized or not. In case the rules outlined above are met, the unrealized expenses / revenues should be non-deductible/non-taxable for profit tax purposes.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i), (ii), (iii), (iv), (v), (vi) The Fiscal Code provides for certain deductibility rules for provisions recorded by companies. Such rules are applicable either to entities acting in the financial sector or to all entities, including those acting in the non-financial sector. Specific provisions for banks As compared to other entities acting in the non-financial sector, credit institutions (e.g. banks) as well as non-banking financial institutions registered in the General Register of the NBR are allowed to deduct in full the *specific risk provisions* (e.g. credit risk provisions) as provided for by statutory laws governing their administration and operation. It should be noted that in case of branches of non-resident banks, the specific risks provisions are recorded according to the laws in their foreign jurisdictions. We are aware of a letter issued by the Ministry of Finance which confirms that in case of the branches of foreign banks (i.e. EU), the deductibility of credit risk provisions should be granted at the level of the provisions set up according to the internal policy of the group/ IFRS and not to the level of the provisions created according to NBR norms.

Romania	
	General provisions Besides the specific risk provisions applicable to banks, there are general tax rules covering the deductibility of provisions recorded by entities. Such rules apply to all entities alike, as follows: a. 30% of the value of provisions for receivables from clients are deductible if the following conditions are cumulatively met: ▪ are registered after 1 January 2004; ▪ are not collected for a period exceeding 270 days as of the due date; ▪ are not guaranteed by another person; ▪ are due by a person that is not a related party of the taxpayer; ▪ were included in the taxable income of the taxpayer; b. 100% of the value of provisions for receivables from clients are deductible if the following conditions are cumulatively met: ▪ - are registered after 1 January 2007; ▪ - are due by a legal person undergoing bankruptcy proceedings, based on a court ruling; ▪ - are not guaranteed by another person; ▪ - are due by a person that is not a related party of the taxpayer; ▪ - were included in the taxable income of the taxpayer. In addition to this, losses recorded further to writing-off of uncollected receivables are deductible either **if covered by a deductible provision**, or whenever one of the

Romania	
	following conditions is met: ▪ - the debtors' bankruptcy procedure was declared closed by a court order; ▪ - the debtor deceased and the receivable cannot be recovered from the heirs thereof; ▪ - the debtor went under dissolution, in case of limited liability companies with a sole shareholder or under liquidation, without any successor; ▪ - the debtor is encountering major financial difficulties that affect his entire patrimony.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	There are no differences in the tax treatment applicable to banks and entities acting outside the financial sector. Under the general rules of the Fiscal Code, any expenses incurred by a company for the benefit of shareholders/associates, other than those incurred for the services rendered by them are considered as non-deductible for profit tax purposes. The Norms of the Fiscal Code includes in this category of non-deductible expenses, as an example, the expenses incurred by a company with stock-option plans granted (i.e. the difference between market price and preferential price of shares). Thus the law is not very clear in what concerns tax treatment for CIT purposes of stock option plans. However, under the current wording of the law, we consider that there are arguments to sustain the deductibility of the expenses incurred with stock-options plan, while considering that such expenses are incurred for services rendered by employees. We are also aware of an informal interpretation of the Ministry of Finance according to which such expenses should be deductible. In order to obtain certainty on the tax treatment, we would recommend applying for a ruling or obtaining a written answer from the Romanian tax authorities (although not

Romania	
	binding).
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) In this respect, we highlight that the Romanian accounting standards provide very descriptive rules for valuation of assets and provisioning which do not allow discretion in the way banks present their balance sheets. 2) Yes – provisions for branches, as set out in section A.6 above.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	N/A

Slovakia	
A. General tax regime applicable to banks	
General comments	There is no special tax for financial institutions in Slovakia. Currently, the Slovak Ministry of Finance presented its proposal to introduce taxation of banks in 2012. It is not yet clear whether it will be a tax levied on the liabilities of a financial institution or a financial activities based tax.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	Except for the rules relating to tax treatment of bad debts provisions and write-off of bad debts (described in detail under section A.6.), no special corporate income tax rules apply to banks in Slovakia, i.e. the tax treatment for banks is the same as for companies active in other sectors. The standard corporate income tax rate in Slovakia is 19%. Banks are not subject to any other income tax yet, however special bank tax (see above) is planned to be introduced from 1 January 2012. Interest income earned on bank accounts, when the account holder is not a bank, is not subject to Slovak VAT. In general, any other income earned by the bank from providing financial services is VAT exempt.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements?	In Slovakia, no special corporate income tax rules apply to banks i.e. the tax treatment for banks is the same as for companies active in other sectors. 1) No 2) No 3) No 4) No

Slovakia	
4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	In Slovakia, no special corporate income tax rules apply to banks i.e. the tax treatment for banks is the same as for companies active in other sectors. 1) Interest charges for loans would generally be tax deductible on an accrual basis when incurred for company's business purposes and set at arm's length. There are currently no thin capitalisation rules. Dividends paid are non-tax deductible. 2) Interest received by Slovak tax residents are subject to a corporate income tax rate of 19%. Under Slovak domestic law, there is no tax on dividends paid out of profits generated in 2004 or later years. Dividends paid out of profits generated before 1 January 2004 are exempt from tax provided specific conditions are met. 3) See our answer relating to dividends under point 2. 4) Interests on advances and on securities are treated on accrual basis. 5) The withholding tax on interest paid abroad is generally 19%, however the provisions of double tax treaties may be applied and reduce the rate. Interest on loans paid to a beneficiary owner resident in another EU country is exempt from withholding tax if specific criteria are met. The WHT applies only on Slovak source income.

Slovakia	
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	In Slovakia, no special corporate income tax rules apply to banks i.e. the tax treatment for banks is the same as for companies active in other sectors. Gains on the sale of fixed assets should be subject to general income tax rate of 19%, the loss on sale of fixed assets is tax deductible.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	The corporate income tax treatment on financial instruments listed under point 1. and 2. follows the accounting treatment and is the same for banks as for non-banking companies. 1) The tax treatment of discounts follows their accounting treatment, i.e. should be included in taxable revenues on accrual basis. 2) The revaluation differences of assets held for trading are included in P&L for accounting purposes and are subject to corporate income tax. The income from sale of such securities is subject to income tax, the loss is tax non-deductible under specific conditions.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	In Slovakia, only specific bad debts provisions can be treated as tax deductible. Tax deductible expense is estimated based on number of overdue days, the amount of bad debt provision created following the IFRS rules and the collateral amount, without taking into account interest provision, and: ▪ For overdue between 361 and 720 days deductible expense is considered to be up to 20% of unpaid loan which exceeds the collateral value, ▪ For overdue between 721 and 1080 days deductible expense is considered to

Slovakia	
	be up to 50% of unpaid loan which exceeds the collateral value, ▪ For overdue greater than 1080 days deductible expense is considered to be up to 100% of unpaid loan which exceeds the collateral value. Write-off of receivables could be treated as tax deductible expense in the amount of bad debt provision that would be treated as tax deductible following the conditions stated above.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	In Slovakia, no special corporate income tax rules apply to banks i.e. the tax treatment for banks is the same as for companies active in other sectors. In general, expenses incurred in connection with the introduction and operation of the employees stock options plans are not tax deductible for CIT purposes.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	The banks in Slovakia, including subsidiaries and branches of non-domestic banks, are obliged to prepare their financial statements according to IFRS.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	We are not aware of situations where the actual tax treatment of banks would differ from the legal provisions.

Slovenia	
A. General tax regime applicable to banks	
General comments	
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) 20% CIT rate, with no surcharges or local taxes. This rate applies to all entities subject to corporate tax. 2) No 3) Generally no, although there are some specific differences (see A.2) 4) No
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) No 2) Thin capitalisation rules apply to most companies, but not to banks. There are also specific rules concerning payments to and by entities located in tax havens (non-EU countries with a general or average nominal corporate tax rate of 12.5% or less, which are included on a list published by the Ministry of Finance and the tax authority). These tax haven rules apply to all Slovenian entities. 3) No 4) No

Slovenia	
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Interest is tax deductible on an accruals basis (subject to potential transfer pricing restrictions), unless the interest is paid to an entity in a tax haven (see A2, question 2). Dividends are tax non-deductible. The same treatment applies to banks as to other entities subject to CIT, except that the thin capitalisation rules do not apply to banks. 2) Interest income is taxable. Dividend income is generally tax exempt, with a nominal non-deductible expense of 5%, which means that in effect 95% of dividend income is deductible. However, where the company paying the dividend is located in a tax haven (see A2, question 2), the exemption does not apply. This tax treatment is the same for banks as for other entities. 3) Payments of dividends are subject to 15% WHT, unless a double tax treaty reduces the rate, or the holding company is an EU tax resident and certain conditions are met, in which case there is no WHT payable under Slovenia's implementation of the EU parent subsidiary directive. 4) There are no special rules and the tax treatment of interest should follow the accounting treatment. Banks in Slovenia have to prepare their accounts under IFRS. 5) There is no WHT on payments of interest made by banks, unless the payments are made to an entity resident in a tax haven (see A2, question 2). Entities other than banks must withhold 15% tax on interest payments to third parties, unless a double tax treaty provides for a lower rate.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Gains and losses on fixed assets are generally taxable / tax deductible as part of the tax base for CIT purposes. The same treatment applies to banks as to other entities subject to CIT.

Slovenia	
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) The tax treatment of discounts on such instruments follows their IFRS accounting treatment as Slovenian tax law does not provide for any specific tax treatment for such items, and Slovenian banks prepare accounts under IFRS. 2) The tax treatment of assets held for trading purposes generally follows their IFRS accounting treatment as Slovenian tax law does not provide for any specific tax treatment for such items, and Slovenian banks prepare accounts under IFRS. Impairments of financial instruments are non deductible when accounted for, and deductible when realised, except for impairments of investments at fair value through profit and loss, which are deductible when booked.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	The tax treatment of bad or doubtful debts on advances and loans differs for banks compared to the treatment for other entities subject to CIT. The treatment for banks is as follows: (i) There is no minimum amount for general provisions (ii)Provisions for warranties, restructuring, expected losses on onerous contracts, pensions, jubilee awards, and termination payments are 50% tax deductible when accrued, and 50% deductible when realised. Other provisions are generally fully deductible (except as outlined under (vi) below). (iii) See (ii) above (iv) The tax law does not address this. (v) Provisions which must be created for special risks under the Act regulating the banking activities are tax deductible up to the amount required by the Act.

Slovenia	
	Revaluation of loans due to impairment is tax deductible for banks up to the amounts set out in the Act regulating banking activities. Provisions for bad debts are non tax deductible unless certain conditions are met (these bad debt rules are the same for all companies). (vi) See (ii) and (iv) above.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Costs related to employee stock option plans are generally deductible, provided that the employees are being taxed on the related income.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Banks should account under IFRS. 2) Generally, banks that are subsidiaries and branches of foreign banks are subject to the same corporate tax treatment as domestic banks, although branches are taxable only on their Slovenian source income.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	As far as we are aware, actual practice does not differ from legal provisions.

Spain	
A. General tax regime applicable to banks	
General comments	In Spain there is no bank levy or any Financial Activities Tax. There are no pending proposals in this respect, either.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) 30%. No differences with ordinary companies. From a direct taxation perspective (Corporate Income Tax) there are some different rules depending on the territory (for instance specific rules applicable to the Vasc region), but these are not surcharges or local direct taxes. 2) No. 3) Tax base is based on accounting profits +- tax adjustments. The only difference with ordinary companies is the tax adjustment regarding bad debt provisions. 4) Two regions in Spain (Extremadura and Andalucía) tax client deposits; rates vary between 0.3% to 0.5%; tax base is the balance of client deposits. These taxes are not turnover taxes but taxes on deposits taken from clients.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of	1) No. 2) Thin Capitalization rules do not apply to financial entities (except tax havens). 3) No. 4) No regarding subsidiaries. Regarding branches, interest payments they make to their head office or to other PEs are tax deductible when calculating the tax base of non residents income tax (in the case of PEs, corporation income tax rules apply, except some exceptions). Interest payments made by branches of ordinary companies are not tax deductible.

Spain	
banks?	
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) No differences. Our initial understanding is that we should identify differences between the applicable taxation on financial entities and other industries. In all of them the tax treatment is similar (interest paid are tax deductible and dividend distributed are not tax deductible) 2) Interest payments are subject to, in general terms, corporation income withholding tax; this WHT is an advance payment of final corporation tax. Interest paid to banks are exempt from WHT. 3) No differences. As a general rule dividends on shares are subject to 19% WHT. Nevertheless, there are some domestic exemptions (for instance dividend paid to shareholders with a specific level of interest on the entity; intra-tax consolidation group dividends; etc.) 4) No differences. 5) Depending of the recipient (no differences with ordinary companies). No, the head office has not to pay any WHT to Spanish tax office because of the payments made by foreign branches of Spanish companies to third parties. The general interest withholding tax rate is 19%.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	No differences. Gain/losses obtained on fixed asset are included on the taxable base (initially according to accounting principles) and subject to the general Corporate tax rate. In certain circumstances differences may apply between the accounting and the tax value of the assets (for instance different depreciation rates;

Spain	
	tax updating coefficients; non-deductible assets depreciation; etc.).
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) No differences. Income obtained on those financial assets are considered as "interest" and included on the taxable base (based on accounting principles) and subject to taxation at general Corporate Tax rate. Please note that tax deductibility on impairments or depreciations is subject to specific rules. 2) No differences. Based on accounting principles. Income/gains obtained on those financial assets are included on the taxable base (based on accounting principles) and subject to taxation at general Corporate Tax rate. Please note that tax deductibility on impairments or depreciations is subject to specific rules.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	Ordinary companies can deduct bad debt provisions 6 months after the first unpayment. Banking entities register bad debt provisions according to accounting rules stated by the Central Bank. These rules state a minimum percentage of provision based on the elapsed time from the unpayment date. Tax rules for the deductibility of bad debt provisions are more restrictive for banks. Regarding general provisions, these are not tax deductible for ordinary companies. In the case of banks, and in general terms, banks can only deduct the annual charge of these provisions up to the limit of 1% of the positive difference of granted qualifying loans generated in the year. In general terms, bad debt provisions hedged with guaranty on rem, because of loan granted to related entities, etc are not tax deductible (both in the case of banks and ordinary companies).

Spain	
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	No differences. It is not possible to analyse this issue briefly, as it is a complex matter and theoretically the answer could depend on the particular circumstances of each case. Nevertheless, the general criteria from the Spanish tax perspective is to considerer as a tax deductible expenses the charge referred to stock options plans for the staff that (i) are registered on P/L account (ii) properly documented and (iii) and based on a contractual or legal obligation to be supported by the entity.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) No 2) No
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	I cannot see clearly the purpose of this question. All prior questions seem to cover general aspects of the Corporate Tax, and consequently actual practices cannot differ at all from tax provisions in that general aspects. Sorry again, but I would need more background on this question to try to understand its purpose and how to answer it.

Sweden	
A. General tax regime applicable to banks	
General comments	Bank levy, effective as from 30 December 2009, for financial years ending after this date is applicable to: Credit institutions and other undertakings that can receive support under the Act: ▪ Swedish banks and other credit institutions that are regulated in the Banking and Financing Business Act, companies set up by such institutions for the purpose of financial reconstruction ("bad banks") ▪ Swedish branches of foreign credit institutions are out of scope of the levy, and are not automatically entitled to Government support Base: ▪ The sum of the liabilities and provisions of the party required to pay the fee – though not untaxed reserves – at the end of the financial year according to the balance sheet adopted ▪ The fee basis for a party required to pay the fee where such party forms part of a group according to the Annual Accounts Act shall be reduced by the corresponding liabilities to other fee-paying undertakings in the Group ▪ The fee basis for a credit institution shall be reduced by the subordinated debt securities that may be included in the capital base under the Capital Adequacy and Large Exposures Act and by the amount of debt which subject to a specific guarantee under the Government Support to Credit Institutions Act Rates

Sweden	
	▪ 0.036 per cent of the fee basis for a full financial year ▪ If the financial year is longer or shorter than twelve months the rate is adjusted accordingly ▪ Reduced by half for financial years 2009 and 2010
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The national income tax rate is 26.3 %. No local taxes are charged. 2) No, banks are taxed at the general corporate rate as per previous answer 3) No. 4) No.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) No specific tax relief rules exist for certain income items. 2) No specific anti-avoidance rules apply. The general anti-avoidance rule applies to all tax payers, but is not specifically aiming at any industry. 3) No. 4) No. These are subject to the general tax rules for Swedish corporates.

Sweden	
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Interest paid is generally deductible as accrued for CIT purposes (subject to general anti-avoidance provisions) and dividends paid are non-deductible 2) Interest received is taxed on an accrual basis. Dividends received are tax on a cash basis unless the participation exemption applies, i.e. dividends on shares in subsidiaries and similar participations may be received tax exempt. 3) Dividends received from domestic companies are not subject to withholding tax. Withholding tax on dividends received is creditable against the Swedish tax liability. 4) Interest is taxable on an accrual basis. The underlying security is taxed on a mark-to-market basis, with an option to tax on a realisation basis if applied to the whole securities portfolio. 5) Not generally, only on interest payments to Swedish resident individuals (natural persons).
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	1) Fixed assets in the form of machinery, equipment or intangible property - gains and losses are recognised for tax purposes, but not necessarily in correspondence with accounting gains and losses as there are special tax rules for the calculation of the gains and losses, rules which operate together with the tax rules on accelerated depreciation. 2) Fixed assets in the form of financial assets - gain and losses are recognised for tax purposes unless subject to participation exemption.

Sweden	
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) The discount is taxable on an accruals basis 2) As stock in trade - all gains and losses are taxable and deductible on a mark-to-market basis, but may also be tax on a realisation basis, see A.2.4
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i) General provisions for losses are not deductible (ii) For deductibility a loss must be seen as "probable", after an assessment on an individual basis. This assessment should be based on circumstances relevant for the specific bad debt. Statistical methods are generally not permitted. (iii) N/A since general provisions are not allowed (iv) Should be based on facts, se (ii) above. (v) Fully deductible if based on facts supporting the risk assessment in the specific case. (v) No, the estimated loss is fully deductible
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Swedish tax rules on employee stock option plans are complex. Depending on the terms of the plan the costs incurred by the employer are deductible or non-deductible. Broadly speaking, plans with a vesting schedule are deductible (and will be tax at a higher rate for the employee) and plans which vest immediately are non-deductible (and will be tax at a lower rate for the employee. There is no difference

Sweden	
	in treatment with respect to banks.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) No. 2) No.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No such differences are known.

UK	
A. General tax regime applicable to banks	
General comments	
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) The corporation tax rate applicable to banks is the same as for other corporations (i.e., currently 28% but will drop by 1% each year from 1 April 2011 to reach 24%). 2) N/A 3) There are differences in the way that a financial trader will calculate its tax liability which primarily relate to items being taxed on trading rather than investment account (for example where shares are held as trading assets a bank will be assessed to corporation tax on dividend income while a non-bank would be exempt on that income). In some instances the accounting treatment will differ between financial traders and other UK companies, and therefore the tax treatment may also change. As a rule, however, the corporation tax rules are similar for banks and other UK companies (although note that there is a separate regime for securitisation vehicles). 4) N/A
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to	1) There are specific computational rules which apply to the taxation of loan relationships and derivative contracts, but these apply to all UK companies and not just banks. 2) While the UK CFC rules apply to all UK companies, there are some additional specific rules which apply only to financial service sector companies (e.g. specific additions to the exempt activities test).

UK	
avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	Thin capitalisation rules apply to all UK companies, but are applied differently to financial services sector companies which cannot apply "safe-harbours" and where the rules are broadly based on the regulatory capital position. Financial services sector companies are additionally excluded from the UK "Debt Cap" rules which limit interest deductions in the available in UK by reference to the group's external borrowing. 3) Not generally. 4) There are specific rules which relate the determination of profits attributable to a permanent establishment of a non-resident bank. These relate to the attribution of loans for tax purposes, and closely follow the principles outlined by the 1984 OECD *Three Taxation Issues report* (e.g. the six loan booking criteria). Branch banks are able to deduct interest paid to other parts of the entity (e.g. to the head office) if the lending is on arm's length terms (subject to branch capital attribution rules).
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign	1) Interest payable to third parties is generally deductible for UK corporation tax purposes (subject to the application of the thin capitalisation rules and unallowable purposes rules). Financial services companies are not generally subject to the "Debt Cap" restrictions applicable to other UK corporations. Dividends payable are not deductible. 2) Interest receivable will generally be taxable in accordance with the UK GAAP or IFRS accounting treatment. Credit relief for overseas withholding tax suffered is restricted by reference to the UK tax payable on the net (rather than gross) income received. Dividends received are taxable where shares are held for the purposes of a trade.

UK	
branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	Credit relief for any withholding tax suffered on dividends received as part of a trade will be restricted such that the credit allowed will not exceed the UK corporation tax on the net (rather than gross) income. 3) No UK withholding on dividends (with the exception of manufactured dividends on net paying non-UK securities, on which tax may be withheld depending on the status of the counterparty). 4) Interest income is generally taxed in line with the UK GAAP or IFRS accounting treatment. 5) Tax is generally withheld at 20% on interest payments, although there is a general exemption for a bank making interest payments in the ordinary course of its business to a company (on payments to UK individuals withholding may be required). The combination of the exemption for banks from withholding tax for payments to a company, and the restriction of withholding to UK individuals only, as well as potentially the UK sourcing rules, means that in practice UK withholding tax on lending from an overseas permanent establishment is not an issue.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	The same treatment applies to a bank as for other UK companies – i.e., chargeable gains are included in profits chargeable to corporation tax. A tax deduction for depreciation in the form of capital allowances may also be available in relation to classes of allowable expenditure.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments	1) Discounts on government bills / trading bills are generally taxed in accordance with the UK GAAP or IFRS accounting treatment.

UK	
treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	2) Bonds etc. held on trading account will generally be taxed in accordance with the UK GAAP or IFRS accounting treatment.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	Bad and doubtful debts on advances and loans to third parties are generally relieved in accordance with their accounting treatment provided that the accounts are prepared in accordance with UK GAAP or IFRS. Please note that a different treatment will apply in the case of loans to connected parties. (i) General provisions for bad or doubtful debts are not deductible for UK tax purposes until they are utilised, but, in practice GAAP compliant accounts under UK GAAP or IFRS will only make specific provisions (i.e. impairments) which are generally allowable deductions for tax purposes. (ii) See above. (iii)See above. (iv) Specific provisions in relation to bad or doubtful debts with third parties are generally allowable deductions for corporation tax purposes. (v) See above. (vi) See above.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Deductions for employee stock options plans are available to banks (and other UK corporations) broadly on the same basis (and at the same time) as they are assed to personal income tax by the employee. There are various specific criteria that must be met in order for a tax deduction to become available, but these are in line with

UK	
	the rules for non-Bank UK corporations. [Please also note that additionally the UK implemented a "Bank Payroll Tax" of 50% for discretionary bonuses above £25k awarded to banking employees between 9 December 2009 and 5 April 2010. The UK Government is also currently consulting in relation to disguised remuneration rules].
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Banks prepare accounts under either IFRS or modified UK GAAP (which is substantially similar). There is a degree of discretion as regards the application of these accounting standards. 2) The UK adopts the OECD approach of hypothesising a permanent establishment of a non-UK company as being a distinct and separate enterprise engaged in the same or similar activitiesand operating under the same or similar conditions. The profits of the PE will be taxed on the basis of GAAP (i.e., UK GAAP or IFRS) in the same way as a UK corporation. As above there are specific rules around attribution, but within these parameters the tax regime which applies to a UK branch and a UK company will be substantially similar.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No significant divergences between practice and the legal provisions.

China	
A. General tax regime applicable to banks	
General comments	
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) 25%, There are no local taxes upon the CIT. Please note that there are local surcharges (Urban Maintenance and Construction Tax of 7%, Education Surcharge of 3%, local education surcharge ranging from 2%-5%, etc) in China, however, imposed only upon the turnover taxes liability, e.g. Business Tax liability. 2) Not applicable. 3) Not applicable. 4) Generally 5% business tax on gross interest and other income of banks.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) For interest income derived from government bonds issued by the Ministry of Finance in China, CIT exemption should be applicable. 2) There are CFC, thin-cap, transfer pricing, anti-avoidance rules under the prevailing China taxation regime. Generally speaking, these rules are applicable to both financial sector and other sectors. However, for thin-cap rules, there are two prescribed debt/equity ratios -- one for enterprises in the financial industry and the other one for non-financial enterprises. The former is set at 5:1, while the latter at 2:1. Where the ratio of the debts from related parties to the equity exceeds the certain prescribed debt/equity ratio in a year, the interest expense pertaining to the debts from related parties shall not be deductible in that year (and no carry-forward to future years), except in situations where certain criteria is met. The prescribed ratio for enterprises in the financial industry is higher than that for non-financial enterprises as financial arrangements in finance industry have their particular

China	
	features. 3) China has concluded double-tax agreements with many countries, and generally these double-tax agreements have not specifically excluded financial companies. 4) There are specific rules for the taxation of subsidiaries and branches of banks, such as bad debt provision, foreign exchange gain or loss, overdue interest income, overseas head office allocation expense, etc.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Interest paid on arm's length basis is generally deductible for CIT purpose by the financial company. Dividend is distributed out of after-tax profit. For interest and dividend paid to overseas companies, generally 10% withholding income tax (or preferential rate under double-tax agreements) will be imposed on such payment. 2) Interest received (after netting of expense) will be liable to 25% CIT. Assuming that the financial company is a Tax Resident Enterprise ("TRE") in China, dividend pick-up from its subsidiaries in China should be exemptible for CIT purpose. For dividend received from its overseas subsidiaries, it is liable to 25% CIT but foreign tax credit might be possible under the double-tax agreements. 3) Generally 10% withholding income tax (or preferential rate under double-tax agreements) will be imposed upon dividend distribution. 4) The PRC tax rules governing the timing for CIT reporting on interest on advances and on securities of all kind are still in a state of flux. Generally CIT is reported following accounting standard (i.e. on accrual basis), but the market-to-market gain/loss could be excluded for CIT purpose whilst only realized gain/loss should be taxable/deductible for CIT purpose.

China	
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Gains realized from fixed assets disposal are liable to 25% CIT. Losses incurred from fixed assets disposal could be deductible for CIT if it is supported with special purpose report, subject to final assessment and approval of Chinese tax authority.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) Generally the discount should be amortized over the tenor of the bond in accordance with effective interest rate method under the PRC GAAP and should be recognized as interest income or a credit to interest income respectively in accounting book. Interest income which is recognized and calculated based on the effective interest rate method should be treated as taxable income and accordingly be subject to 25% CIT. 2) For assets held for trading purposes, generally CIT is reported following accounting standard (i.e. on accrual basis), but the market-to-market gain/loss could be excluded for CIT purpose whilst only realized gain/loss should be taxable/deductible for CIT purpose.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(i) No. (ii) Deduction allowed within limitation. (iii) Limited to 1% on the permitted scope of loan assets, subject to the following calculation formula: *CIT deductible loan provision for the current year = closing balance of permitted scope of loan assets at the current year end x 1% - CIT deducted loan provision as of the end of previous year* (iv) Specific provisions are allowed for agricultural-related loans and loans to small

China	
	and medium-sized enterprises where certain criteria are met. (v) Deduction allowed within limitation. (vi) Limited to 2% on attended loan, 25% on subprime loan, 50% on doubtful loan, and 100% on loss loan
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	The prevailing PRC taxation regime has not clarified the CIT treatment on employees stock options plans. In practice it is difficult for financial companies to claim CIT deduction for equity compensation charges. However, there might be an argument to claim CIT deduction if the employees stock options is treated as expense related to the financial company's business operation and the related PRC individual income tax is reported.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	1) Generally not allowed. 2) No.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	Please kindly note that the PRC taxation system governing financial institution is in a state of flux and there might be inconsistencies in the application and enforcement of the PRC tax rules by different cities and provinces.

Singapore	
A. General tax regime applicable to banks	
General comments	There is no bank levy and we are not aware of any proposal to introduce one in Singapore.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) Prevailing corporate tax rate is 17% but there are certain concessions available to banks (see comments in A2). There are no local taxes. 2) Yes. See comments in A2. 3) There is generally no difference in calculating the corporate tax base for companies in the financial and non-financial sectors. 4) Singapore does not impose turnover taxes. However, Singapore imposes a goods and services tax (GST), which is akin to value added tax in the UK and Europe. Very broadly, under the GST legislation, financial supplies (as defined) are either exempt from tax (if supplied to a person belonging in Singapore) or zero-rated (if supplied to a person belonging outside Singapore).
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits?	1) Yes. Banks can apply to enjoy concessionary tax rate(s) for a range of activities under the Financial Sector Incentive (FSI) Scheme. Under the FSI Scheme, qualifying activities are grouped into two main categories, Standard-Tier (ST) and Enhanced Tier (ET) where qualifying income from the respective categories is taxed at 12% and 5% respectively. The FSI-ET award caters for high growth and high value-added activities. Such activities include those relating to bond market, derivatives market, equity market

Singapore	
3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	and credit facilities syndication etc. For example, income derived from arranging, underwriting or distributing certain debt securities will qualify for 5% tax. FSI-ST caters to a broader range of financial activities that are important to Singapore's financial sector development objectives. Examples include lending (in foreign currencies), treasury and various debt and equity capital market activities (not covered in the ET scheme). 2) Singapore does not have CFC or thin capitalisation rules. The tax treatment of certain financial transactions is subject to the observance of anti-avoidance considerations and/or arm's length requirement e.g. stock lending, securitisation and withholding tax treatment of financial derivatives payments to non-residents. (These financial transactions are more commonly entered into by financial institutions). In addition, general anti-avoidance rules do apply to both banks and non-banking entities. 3) There are no specific exclusions of financial companies from double-taxation agreements. 4) There are generally no special tax rules that treat a bank organised as a branch differently from one organised as a subsidiary. Unlike a subsidiary, a Singapore branch of a foreign corporation is regarded as a non-resident. For this reason, certain types of payments made by Singapore-based payers to the Singapore branch are subject to withholding tax. However, application for waiver can be obtained through an application to the Singapore tax authorities on the basis that the Singapore branch is already paying tax locally. Further, as a branch is unlikely to be a resident in Singapore, it cannot claim foreign tax credit nor claim tax exemption for foreign income received in Singapore.

Singapore	
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	Dividend Dividend payments by a Singapore company are not subject to withholding tax in Singapore. Foreign dividends received in Singapore are **taxable** unless they are specifically exempted under the Income Tax Act (ITA). The exemption is only available to Singapore resident companies and is subject to meeting certain conditions. Where the conditions for exemption are not met, the Singapore resident company may claim foreign tax credit. A branch, not being a resident, will not be able to enjoy tax exemption on foreign-sourced dividends nor claim double tax relief. However, as a concession Singapore branches of foreign banks may claim a deduction of the foreign tax suffered, subject to certain conditions. Interest Generally, interest expenses that are incurred in the production of taxable income are deductible. Interest income is *generally* taxed on accrual basis for banks. Interest income is taxable at the prevailing rate (currently 17%) unless it is reduced under an applicable tax incentive (see our comments in A2). In respect of interest income derived on loans made by Singapore branches of foreign banks to foreign borrowers, the banks will generally adopt one of the following approaches: (1) Lender bears tax (LBT) – bank being the lender bears the withholding tax on the interest from loans (2) Borrower bears tax (BBT) – the borrower bears the withholding tax, i.e.

Singapore	
	interest income accrued to the lending bank from the loan is net of any foreign withholding tax. For loans made under the LBT approach, the tax deduction to be allowed for the foreign tax shall not exceed the net income from the loans in respect of which foreign tax has been deducted. This capping will be applied on a per country basis for each category of income. Interest income will be brought to tax at gross. For loans made under the BBT approach, the Singapore branches of foreign banks are dispensed with the requirement to regross the interest income with foreign tax and apply the capping rule. The interest income under this approach will be brought to tax net of foreign tax deducted. 5) Under domestic law, withholding tax is applicable on interest paid to non-residents. However, the government has granted a remission of withholding tax on all interest and related payments made by approved banks in Singapore to their overseas branches, head offices or another branch outside Singapore. Based on the recent Singapore Budget, it was announced that with effect from 1 April 2011, banks and certain financial institutions will be exempted from withholding tax on interest and related payments made to all non-residents (other than permanent establishments in Singapore) so long as these payments are made for trade or business purposes. This exemption is for such payments made during the period 1 April 2011 to 31 March 2021. Under domestic law, interest paid to non-residents is subject to withholding at the prevailing corporate tax rate (currently 17%). However, this rate will be reduced to 15% if such payments are not derived by the non-resident from any trade, business, profession or vocation carried on or exercised in Singapore and are not effectively connected with any permanent establishment in Singapore of that non-resident. This tax rate is the final tax payable, meaning the non-resident cannot file a tax return to

Singapore	
	claim expenses so as to obtain a refund of taxes. In your example, interest payment is arising from a business carried on outside Singapore through a PE located outside Singapore. Withholding tax is not applicable as the interest is not derived from Singapore.
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	Singapore does not impose tax on capital gains. Hence, gains and losses of a capital nature are ignored for tax purposes (i.e gains not brought to tax, losses not allowed for tax deduction), That being said, tax depreciation is available for qualifying assets. There is no difference in tax treatment for fixed assets between banks and other industry sectors.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	It is likely to be trading (revenue) assets compared to non-financial sector. Very broadly, gains and losses arising from financial instruments of a revenue nature would be assessable and deductible respectively, whereas those of a capital nature will be ignored for tax purposes. Gains and losses from financial instruments are *generally* of a revenue nature in the hands of financial institutions that deal in these instruments in their ordinary course of business. Strictly, gains will be taxed when they are realised, whereas losses will be allowed a deduction when they are incurred. However, banks which adopt FRS 39 (the local equivalent of IFRS 39) in the preparation of their financial accounts may (subject to some exceptions) elect to report such gains and losses to tax based on the amounts reflected in the income statement.

Singapore	
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	With the introduction of FRS 39, general and specific provisions for bad or doubtful debts will no longer be made. Impairment losses are recognised under certain circumstances as prescribed in the accounting standard. Impairment losses incurred on financial assets on revenue account will be allowed a deduction and any reversal amount will be taxed. For banks which do not have a robust loss estimation process and are unable to provide for collective impairment under FRS 39, they are required by the banking regulator to maintain a certain level of impairment provisions. As a concession, the amount of general provisions determined will be deductible subject to the conditions stipulated in the ITA. An auditor's certification is required to support the deduction claim.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	There is no difference in tax treatment for the employees stock options plan (ESOP) between a financial institution (FI) and non-FI. The tax treatment of ESOP is as follows: (i) Income statement adjustments required by the application of the Financial Reporting Standard (FRS) 102 and the gain/losses recognised upon transfer/disposal of treasury shares are disregarded. (ii) Tax deductions are allowed in relation to the ESOP only in the following situations:

Singapore	
	A. Where the ESOP shares are shares in the Company, the shares were bought by the Company as treasury shares for that purpose. b) Where the ESOP shares are shares in the Company's parent company, ▪ The shares are bought by the parent company as treasury shares for the Company's employees; and ▪ An amount was recharged to the Company by the parent company. In either case, the amount to be deducted is restricted to (a) the cost of acquiring the shares, less the amount, if any, paid by the employees for the shares or (b) the amount of recharge from parent (in the case of treasury shares of the parent), whichever is the lower. And the cost of the treasury shares purchased is to be computed on a "First-in-first-out" (FIFO) or weighted average method. Please also note that should the expenses in the profit and loss account relates to the recharge from the parent company for new shares issued by the parent company to the Company's employees, no tax deduction can be claimed for the recharge. With the Budget announcement 2011, the tax authorities have expanded the scope of deduction to allow ESOP scheme administered through a special purpose vehicle. Details have yet to be released.
B. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to	None that are not already stated above.

Singapore	
subsidiaries and branches of non-domestic banks?	
C. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	Generally no.

Switzerland	
A. General tax regime applicable to banks	
General comments	▪ Swiss banks are regulated by the Swiss Financial Market Supervisory Authority (FINMA) and therefore subject to stricter regulations compared to companies in the non-financial sector (e.g. equity basis). ▪ In general the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP. Compared to other accounting standards, Swiss GAAP provides a lot of flexibility and has fewer strict rules. Hence, there is usually more than one way to appropriately reflect a transaction in the financial statements, although slightly stricter rules apply for financial services industry. ▪ There is no bank levy or special financial activities tax in Switzerland. We are not aware of any (pending) proposals in this respect.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	1) Same treatment as non-financial sector. The applicable effective CIT rate (including cantonal/communal and direct federal tax) for FY 2010 varies between 12.66% and 24.23%, depending on the canton the company is located. Based on the respective cantonal tax law, surcharges and added local taxes may be levied mainly in the French speaking cantons (e.g. "Taxe Professionnelle Communale" of the Canton of Geneva). 2) Same treatment as non-financial sector. There is no special tax rate applicable for banks in Switzerland. Swiss companies may benefit of a privileged tax status (e.g. holding company or mixed company), however, banks usually do not fulfil the respective requirements 3) In general same treatment as non-financial sector i.e. the taxable profit corresponds to the profit according to the statutory financials, which are based on Swiss GAAP. However, depending on cantonal tax practise there are some rules regarding depreciation and provisions, that slightly differ between banks and non-banks; e.g.

Switzerland	
	canton Zurich with respect to limitation of tax deductibility, for banks there are slightly lower lump sum adjustments on securities and precious metal (up to 10% on Swiss bonds and up to 20% on other values), on client credit balances and on mortgage claims (up to 5% on Swiss clients and up to 7% on foreign clients, compared to 10%/20% for non-banks). 4) Same treatment as non-financial sector. Please note, that most financial service income, i.e. cash and capital market revenues like interest, turnover on securities or dividend, are not taxable for VAT purposes.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?	1) Same treatment as non-financial sector. 2) Same treatment as non-financial sector, except the Swiss Thin Cap rules: the general Swiss Thin Cap rules do not apply for Swiss banks; the equity base of Swiss banks is determined by the Swiss Financial Market Supervisory Authority (FINMA) and considered as sufficient by the tax authorities. 3) Same treatment as non-financial sector. 4) Same treatment as non-financial sector.
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT?	1) Same treatment as non-financial sector. Interest payments are principally tax deductible (arm's length principle to be considered); dividend distributions are not tax deductible.

Switzerland	
3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	2) Same treatment as non-financial sector. Interest income is subject to ordinary CIT; dividend income from portfolio shareholding is subject to ordinary CIT; participation relief is applicable if the participations exceeds 10% or its has a fair market value of above CHF 1m. 3) Same treatment as non-financial sector. Dividend distributions are subject to 35% Swiss WHT; refund possible for Swiss shareholders based on Swiss tax law or based on a double tax treaty / bilateral agreement with the EU for foreign shareholders. ; 4) Same treatment as non-financial sector. For Swiss statutory accounting, interest is recognised on an accrual basis. (i) In general no WHT is due if interest is paid by non-banks. However, WHT of 35% is due for interest paid by banks to third parties. If the interest is paid from a bank to another bank, the income is not subject to WHT. (ii) Yes, if the foreign branch qualifies as Swiss resident for WHT purposes. This is not the case, if (1) the foreign branch qualifies and is regulated as a bank in the foreign jurisdiction, (2) does not promote its products in Switzerland and (3) the client bears the transfer risks. Under these circumstances, the interest paid by the foreign branch is not subject to Swiss WHT. In general no Swiss WHT is due if the foreign branch does not qualify as Swiss resident for Swiss WHT purposes.
D. Tax treatment of some specific gain/losses	
	Same treatment as non-financial sector. In general the Swiss tax treatment follows the Swiss accounting treatment according

Switzerland	
1. How are gains and losses on fixed assets treated for tax purposes?	to Swiss GAAP. In principal, capital gain is taxable, losses are tax deductible. Note that (a) capital gains on the sale of participations exceeding 10% are subject to the participations relief, provided that the holding period exceeds one year and that (b) a special capital gains tax may be levied on the sale of real estate (depending on the canton).
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes? 2. How are assets held for trading purposes treated for tax purposes?	1) Same treatment as non-financial sector. The lower of cost or market applies; for accounting purposes, the discount is realised at pay back. Note in this respect that in principle the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP. Compared to other accounting standards as IFRS or US GAAP, Swiss GAAP does not follow the true and fair view approach. 2) Same treatment as non-financial sector. A mark-to market approach can be applied for assets held for trading purposes under the current assets. Note in this respect that in principle the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP. Compared to other accounting standards as IFRS or US GAAP, Swiss GAAP does not follow the true and fair view approach.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes?	Same treatment as non-financial sector. (i) No minimum required

Switzerland	
(i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	(ii)/(iii) Note that from a Swiss accounting perspective, general provisions are in principle not limited (as Switzerland is not follow the true and fair view approach). However, from a tax perspective, the cantonal tax administration have issued respective safe harbour guidelines, which may slightly differ between banks and non banks (e.g. canton Zurich with respect to limitation of tax deductibility, for banks there are slightly lower lump sum adjustments on securities and precious metal (up to 10% on Swiss bonds and up to 20% on other values), on client credit balances and on mortgage claims (up to 5% on Swiss clients and up to 7% on foreign clients, compared to 10%/20% for non-banks). (iv)/(v)/(vi) There is in principle no limitation from a Swiss accounting perspective. From a tax perspective however, the deductibility is limited to the amount that can be justified.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Same treatment as non-financial sector Costs for employee stock options should be deductible for CIT purposes (as personnel expense). In general the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP. In principal, any expenses in connection with stock option plans should be tax deductible if they qualify as commercially justified expense.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital? 2. For all above questions, are there differences in the provisions applicable to	1) Same treatment as non-financial sector. Swiss GAAP does not apply the true and fair view approach. Therefore, significant hidden reserves may be possible (i.e. difference between fair market value and lower book value). However, over-statement is not accepted.

Switzerland	
subsidiaries and branches of non-domestic banks?	2) No.
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No.

The United States of America	
A. General tax regime applicable to banks	
General comments	There is currently no bank levy in the United States. Proposals made in 2010 did not garner sufficient Congressional support. A recent 2011 proposal by the Obama Administration is, at this point, also unlikely to garner sufficient Congressional support to be enacted, especially in the House of Representatives.
1. What is the applicable corporate income tax ("CIT") rate, including possible surcharges and local taxes (in which case the capital city is considered)? 2. Do banks receive a special tax rate or can they qualify for a special tax rate? 3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If yes, in which respect? 4. Do countries impose turnover taxes on gross interest and other income of banks?	Maximum 35% federal rate. State and local rates vary. Some special rates may apply to banks locally. This can vary widely across jurisdictions. Foreign banks are subject to special tax base computation rules. Domestic banks are not. No federal turnover tax.
B. Specific tax regime applicable to banks	
1. Do countries have specific tax relief rules for some specific items such as interest income? 2. Are there specific anti-avoidance rules (CFC, Thin Cap, etc.) that apply to the financial sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits? 3. Are (some) types of financial companies excluded from double-tax agreements? 4. Do countries have specific rules for the taxation of subsidiaries and branches of	Specific exemptions apply to certain types of income (e.g., municipal bond interest). There are specific anti-avoidance rules that apply to the financial sector. Many of these relate to profit offshoring. Certain types of financial companies are subject to special rules regarding treaty applicability, though no exclusions come to mind immediately. Special rules apply for the taxation of certain subsidiaries and branches.

The United States of America	
banks?	
C. Tax treatment of interest and dividends	
1. How are interest and dividend paid treated for tax purposes under CIT? 2. How are interest and dividend received treated for tax purposes under CIT? 3. How are dividends on shares treated for tax purposes (from a WHT perspective)? 4. How are interest on advances and on securities of all kind treated? Accrual basis, mark-to-market or included with the value of the security? 5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?	1) Generally interest is tax deductible. Dividends paid are not. Exceptions and special deductions may apply. Rules are too complex to generalize. 2) Generally interest and dividend income is taxable. Exceptions and special deductions may apply. Rules are too complex to generalize. 3) Subject to withholding (generally). Treaty-based rate reduction may apply under certain circumstances. 4) Interest generally subject to tax on accrual basis though exceptions may apply. 5) Interest is generally subject to withholding tax. Special rules apply to foreign bank branch interest expense - generally not subject to US withholding (treated as foreign source income).
D. Tax treatment of some specific gain/losses	
1. How are gains and losses on fixed assets treated for tax purposes?	If "fixed assets" are real property assets, special tax rules apply that generally subject gains to withholding. Complex rules apply. If "fixed assets" refers to something else, please clarify.
E. Tax treatment of some financial practices/instruments	
1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes?	1) Define "discounts". This is unclear. If original issue discount, then generally taxable on an accrual basis based on constant yield amortization. 2) Complex rules apply to trading assets. This question would need to be made

The United States of America	
2. How are assets held for trading purposes treated for tax purposes?	more specific for us to provide a concrete answer.
F. Tax treatment of bad or doubtful debts on advances and loans	
1. How are bad or doubtful debts on advances and loans treated for tax purposes? (i) Are there minimum required for general provisions? (ii) Tax deductibility of general provisions? (iii) Limitation on deductibility of general provisions? (iv) Are specific provisions discretionary? (v) Tax deductibility of specific provisions? (vi) Limitation on deductibility of specific provisions?	Generally deductible. Depending on the nature of the taxpayer holding the debt, deductions may be allowed for partially worthless instruments or for wholly worthless instruments. Applicable rules are extremely complicated. In the case of a bank or other corporation subject to supervision by federal or certain state authorities, the U.S. regulations provide a presumption of worthlessness to the extent that a debt is written off in accordance with specific orders of the authority or if, upon audit by the authority, the authority confirms that the write off would have been ordered had it not been made voluntarily. Since 1992, such a bank or thrift institution may, by making a "conformity election," adopt a method of tax accounting under which it claims the bad debt deduction in the year the debt is charged off pursuant to the taxpayer's method of regulatory accounting; provided, the institution's supervisory authority has made an express determination that the bank maintains and applies loan loss classification standards that are consistent with the regulatory standards of the supervisory authority.
G. Tax treatment of employees stock option plans	
1. Are employees stock options plan deductible for CIT purposes?	Generally yes, though special timing rules apply. These rules are too complex to summarize, and will almost certainly create a book/GAAP - tax difference.
H. Specific questions regarding banks	
1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital?	This is not a tax question. I cannot answer it. Please advise if you require a referral to a bank regulatory expert.

The United States of America	
2. For all above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?	
I. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	

ENCLOSURE 10: VAT QUESTIONNAIRE TO EU MEMBER STATES

Country:

General remark

When providing your answers, please take into account the fact that the reference tax year is 2011.

QUESTION 1: Option for taxation

Article 135(1) of Directive 2006/112/EC applies, which exempts financial services, for your country.

Can you please confirm that your country has adopted article 137(1)(a) of Directive 2006/112/EC to allow taxable persons a right of option to tax financial transactions referred to in points (b) to (g) of article 135(1)?

- Yes/No

If not, does your country envisage adopting article 137(1)(a) of Directive 2006/112/EC in the near future?

If so, to what extent does your country use article 137(1)(a) of Directive 2006/112/EC?

We would appreciate it if you could provide your comments with respect to the extent to which article 137(1)(a) has been implemented in the attached template. We have already completed the template for Belgium as an example.

QUESTION 2: Taxes to compensate for the general VAT exemption

Has your country introduced other Taxes to specifically compensate for the general VAT exemption for the Financial Sector (e.g. payroll taxes, a tax on insurance contracts similar to VAT but not allowing for the deduction of input VAT, stamp duties, Contracts for Difference, etc.)?

- Yes/No
- If so, please provide us with an overview of the taxes concerned and their procedures

We would appreciate it if you could provide your comments with respect to the procedures governing these taxes in the attached template.

ENCLOSURE 11: VAT TEMPLATE

Option to Tax:

Country	Transactions envisaged	Application	Formalities	Taxable base	Revocation	Treatment of cross-border transactions	Extent of use
BELGIUM	Limited to payment and receipt transactions, including negotiation but excluding debt collection (article 44, § 3, 8° of the Belgian VAT Code) Payment transactions are transactions whereby a person takes care of payments for the account of another person. Receipt transactions are transactions whereby a person collects payments for the account of another person	Once exercised, applicable to **all** payment and receipt transactions Not limited to banks and insurance companies No specific requirements with respect to customer	Option exercised, via signed written declaration (in twofold) mentioning the name, address and Belgian VAT number of the VAT'able person The Belgian VAT authorities will send one of the declarations back to the VAT'able person with stamp and date of receipt	The normal VAT rules with respect to the taxable base apply	Once exercised, the option is irrevocable	**Outgoing payment and receipt transactions:** Applicable to local and cross-border transactions The VAT'able person will have a right to deduct Belgian VAT with respect to cross-border payment and receipt transactions, even in case the service is not subject to VAT in the Member State of the recipient **Incoming transactions**: a VAT'able person who has exercised the option, should also subject its incoming payment and receipt transactions from foreign service providers located in Belgium following the general B2B rule to VAT	The big and several medium-sized banks in Belgium have opted to tax in view of optimising their right to deduct Belgian VAT with respect to IT costs. The option to tax is also used by payment factories established in Belgium

Country	Transactions envisaged	Application	Formalities	Taxable base	Revocation	Treatment of cross-border transactions	Extent of use
YOUR COUNTRY							

Other Indirect Taxes to Compensate for the General VAT Exemption:

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base
BELGIUM					
YOUR COUNTRY					

ENCLOSURE 12: VAT QUESTIONNAIRE TO KEY THIRD COUNTRIES

Country:

General remark

When providing your answers, please take into account the fact that the reference tax year is 2011.

QUESTION 1: Exemption for financial services

For EU Member States, article 135(1) of Directive 2006/112/EC applies, which exempts financial services.

Article 135(1) of Directive 2006/112/EC: Member States shall exempt the following transactions:

1. ***a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents;***
2. ***b) the granting and the negotiation of credit and the management of credit by the person granting it;***
3. ***c) the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit;***
4. ***d) transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection;***
5. ***e) transactions, including negotiation, concerning currency bank notes and coins used as legal tender, with the exception of collector's items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest;***
6. ***f) transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures and other securities, but excluding documents establishing title to goods and the rights or securities referred to in article 15(2);***
7. ***g) the management of special investment funds as defined by Member States.***

Do similar provisions apply for your country for VAT, sales taxes or consumption taxes of the same nature?

- Yes/No

If so, please gives us more information on these provisions as well as the specific procedures? Please inform us whether there is a specific regime with respect to the right to deduct VAT, sales tax or consumption taxes of the same nature for financial service providers.

QUESTION 2: Option for taxation

Article 137(1)(a) of Directive 2006/112/EC:

Member States may allow taxable persons a right of option for taxation in respect of the following transactions:

a) the financial transactions referred to in points (b) to (g) of article 135(1);

Does your country have similar provisions?

- Yes/No

If so, please gives us more information on these provisions as well as the specific procedures?

ENCLOSURE 13: VAT, SALES TAX OR CONSUMPTION TAXES IN THIRD COUNTRIES

US

In the United States, there is no VAT regime. The tax on consumption is a Sales Tax which is imposed at State level on the supply of tangible items and certain specific services. There is no national consumption tax.

The State level Sales Taxes vary from state to state both as to their base and their rates. Rates generally range from 4% to 10%, with the average at 7%. None of the States imposes Sales Taxes on any of the financial services listed in article 135(1) of EU VAT Directive 2006/112/EC.

Many States do, however, have distinct taxes on insurance companies. These taxes are known as "Premium Taxes", and are levied as a percentage of the premiums received by insurance companies for insuring risk in that particular State.

China

We first provide an overview of China's indirect tax system. VAT and Business Tax are the two main types of indirect taxes in China.

The sale or importation of goods and the provision of repairs, replacement and processing services are subject to VAT. The input VAT incurred on purchases is generally creditable (i.e. recoverable) against output VAT. The normal VAT rate is 17%.

Non-vatable services (i.e. services that do not constitute repair, replacement or processing services) that are provided in China, along with the transfer of real property and intangible assets, are normally subject to Business Tax. Non-vatable service providers are liable for Chinese Business Tax where either the service provider or the service recipient is located in China. Business Tax is generally charged on gross revenue and cannot be credited (i.e. unlike VAT, no offsetting amount can be recovered). Business Tax rates range from 3% to 20%. The normal rate is 5%.

Specifically in relation to financial transactions, the current Chinese indirect tax system results in financial institutions generally being subject to Business Tax, where applicable, at the rate of 5% (and not to VAT). Business Tax is generally assessed on financial institutions on a gross basis (i.e. loans, interest income, service fees and bank charges). However, there are certain circumstances where it may be calculated on a net basis (i.e. the trading of financial products such as bonds, stocks, etc.). This model therefore creates uncertainty as to which revenue streams will, for Business Tax purposes, be calculated on a net basis as against a gross basis and how to treat revenue streams derived from new financial products.

As it currently stands, levying Business Tax on revenue derived by financial institutions continues to be an effective method for raising tax revenues for the Chinese government and, therefore, there may be some reluctance to change the existing rules.

Notwithstanding, the Chinese government is currently carrying out a process of VAT reforms, one of which may entail merging the existing Business Tax system into VAT.

Whilst it is too early in the reform process to comprehend the exact scope of any such reforms and when/how they will affect the financial services industry, there are likely to be ramifications for the industry should the reforms proceed.

Singapore

Under the fourth Schedule to the Singapore Goods and Services Tax Act, the following financial services are exempt:

- operation of any current, deposit or savings account;
- exchange or grant of an option for the exchange of currency (whether effected by the exchange of bank notes, currency notes or coin, by crediting or debiting accounts, or otherwise) other than the supply of a note or coin as a collector's item, investment article or item of numismatic interest;
- any supply by a person carrying out a credit card, charge card or similar payment card operation made directly in connection with that operation to a person who accepts the card used in the operation when presented to him in payment for the goods or services;
- the issue, payment, collection or transfer of ownership of any note or order for payment, cheque or letter of credit or notification of the issue of a letter of credit;
- the issue, allotment, transfer of ownership, drawing, acceptance or endorsement of a debt security;
- the issue, allotment or transfer of ownership of an equity security;
- the provision of any loan, advance or credit;
- the provision of an instalment credit finance facility under a hire-purchase, conditional sale or credit sale agreement, for which facility a separate charge is made and disclosed to the recipient of the supply of goods;
- the transfer or assignment of provision of an instalment credit finance facility under a hire-purchase agreement;
- the grant of a right or option relating to an obligation to pay interest or exchange or grant of an option for the exchange of obligations to pay interest;
- renewal or variation of a debt security, equity security or contract for the provision of any loan, advance or credit;
- the provision or transfer of ownership of a life insurance contract;
- the provision of insurance cover or annuities under any specified CPF scheme;
- the provision or assignment of any futures contract, including a futures option transaction that does not lead to a delivery of any goods from the seller to the buyer;
- the provision or assignment of any option or contract for the sale of any unallocated commodity that does not lead to delivery of the commodity from the seller to the buyer;
- the grant of a right or option to acquire any unallocated commodity where the right is exercisable at a future date and any sale resulting from exercise of the right would constitute a sale that does not lead to delivery of the commodity from the seller to the buyer;
- the issue or transfer of ownership of a unit under any unit trust or business trust;

- the arrangement, provision or transfer of ownership of any contract of re-insurance;
- the provision of financing in connection with a qualifying Islamic financial arrangement in relation to non-residential property, for which the provider of the financing derives an effective return;
- the issue or transfer of ownership of Islamic debt securities under an Islamic debt securities arrangement;
- the provision of financing under an Islamic debt securities arrangement for which the provider of the financing derives an effective return.

Some examples where the exemption does not apply include:

- direct insurance (only the provision of life insurance and reinsurance (including reinsurance broking) is exempt);
- management services (e.g. for funds);
- services consisting of arranging, broking, underwriting or advising on exempt financial services.

A bank registered for Goods and Services Tax in Singapore will recover its Goods and Services input Tax based on a fixed rate, which is revised annually. The fixed rate is dependent on the type of licence the bank holds.

Other than banks, all other financial institutions have to use a standard input tax recovery formula to compute the amount of Goods and Services Tax they can claim if they make exempt supplies (and if the exempt supplies made do not qualify under the exception rules such that the input tax can be claimed in full). Financial institutions can also seek approval from the tax authority to use a special formula.

Switzerland

Under section 21(2) of the Swiss VAT Act, the following services are exempt from VAT without credit:

- par.18: insurance and reinsurance, including turnover from acting as an insurance agent or insurance broker;
- par.19: the following turnover in the field of money and capital transactions:
  - (a) granting and intermediation in the granting of credits and the management of credits by lenders;
  - (b) the intermediation in and assumption of liabilities, bails and other securities and guarantees and the management of collaterals by lenders;
  - (c) turnover, including intermediation, in deposit and current account transactions, payment and transfer transactions, business with money claims, cheques and other negotiable paper; however, the collection of debts on behalf of a creditor (debt-collection business) is taxable;
  - (d) turnover, including intermediation, relating to legal tender (domestic and foreign legal tender, such as currencies, bank notes, coins); however, collectors' items (bank notes, coins) that are not normally used as legal tender are taxable;
  - (e) turnover (spot and forward transactions), including intermediation, of securities, rights and derivatives and of interests in companies and other forms of associations; however, the safe-keeping and management of securities, rights and derivatives and of interests (especially safe-keeping) including fiduciary investments are taxable;
  - (f) the sale of interests in and the management of collective investments under the Swiss Federal Schemes Act of 23 June 2006 by persons managing or keeping them, fund management companies, depositary banks and their agents; agents are all individuals or legal entities, to whom the collective investment scheme may delegate tasks according to the Act; the sale of interests in and the management of closed-end investment companies under section 110 of the Act is covered by par. (e).

The Swiss regulations on the taxation of financial services are fairly similar to those in the European Union but vary in detail from the EU rules.

However, at the end of 2010, the Swiss Federal Tax Administration published a draft of its new administrative guidance for the financial services industry on the new Swiss VAT Act, which came into force on 1 January 2010. The most important change the Administration intends to implement is the new definition of intermediary services for financial transactions. Basically, it looks as if they will adopt the European Court of Justice's interpretation of Directive 2006/112/EC in the cases of CSC Financial Services Ltd (C-453/05 of 21 June 2007) and Volker Ludwig (C-235/00 of 13 December 2001).

No specific regime has been implemented in the Swiss VAT Act with respect to the right to deduct input VAT for financial service providers. In particular, there is no equivalent in Switzerland of the EU rule that services supplied exempt from VAT to a recipient resident in a third country entitle the supplier to deduct his input VAT.

However, in order to reduce administrative costs, in its administrative guidance, the Swiss Federal Tax Administration offers insurance companies and banks industry-specific lump-sum methodologies as a partial exemption method.

ENCLOSURE 14: OPTION TO TAX FINANCIAL SERVICES IN EU MEMBER STATES

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
AUSTRIA	Option to tax adopted to a very limited extent, i.e. for certain very specific financial services according to article 135(1)(b) and (c) of Directive 2006/112/EC	Grant of a loan in direct connection with a supply of goods or a supply of services, i.e. the supplier gives credit for the consideration for the supply of goods/supply of services to the recipient (purchaser)	The option can be exercised for each supply of goods/supply of services Not limited to financial institutions No specific requirements with respect to the customer	The Austrian VAT Act does not lay down any specific formalities The option is exercised by the supplier (taxable person) reporting the interest as a service subject to Austrian VAT in the monthly/ annual VAT return. The Austrian VAT rate depends on the VAT rate applicable for the underlying supply of goods/services	The normal VAT rules apply with respect to the taxable basis	Once exercised, the option is revocable until the VAT assessment comes into effect. This means that a transaction that was initially treated as subject to VAT can be treated as VAT-exempt until such time as the VAT assessment comes into effect	**Outgoing transactions:** If the service rendered is deemed to be carried out in another EU Member State, the supplier of the service is entitled to input VAT deduction under the following conditions: - if the service was deemed to be carried out in Austria, the supplier could opt for taxation - the VAT legislation of the other EU Member State also provides the possibility to opt for taxation for this supply of services - the supplier of the service has to prove that the customer has treated the supply of service as subject to VAT in the other EU Member State	There is no statistical data available on the use of the option to tax	N/A
		Dealing in credit guarantees in connection with credit-card business, i.e. guarantee of payment by the credit card company to the merchant	The option can be exercised for each service rendered Limited to credit card companies No specific requirements with respect to the customer	The Austrian VAT Act does not lay down any formalities The option is exercised by the supplier (taxable person) reporting the service rendered as subject to 20% Austrian VAT in the monthly/annual VAT return	The normal VAT rules apply with respect to the taxable basis	Once exercised, the option is revocable until the VAT assessment comes into effect. This means that a transaction that was initially treated as subject to VAT can be treated as VAT-exempt until the VAT assessment comes into effect	**Outgoing transactions:** If the service rendered is deemed to be carried out in another EU Member State, the supplier of the service is entitled to input VAT deduction under the following conditions: - if the service was deemed to be carried out in Austria, the supplier could to opt for taxation - the VAT legislation of	There is no statistical data available on the use of the option to tax	N/A

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
							the other EU Member State also foresees the possibility to opt for taxation for this supply of service - the supplier of the service has to prove that the customer has treated the supply of service as subject to VAT in the other EU Member State		
BELGIUM	Option for taxation adopted to a very limited extent, i.e. for certain very specific financial services according to article 135(1)d of Directive 2006/112/EC	Limited to payment and receipt transactions, including negotiation but excluding debt collection (article 44, § 3, 8° of the Belgian VAT Code) Payment transactions are transactions whereby a person takes care of payments for the account of another person. Receipt transactions are transactions whereby a person collects payments for the account of another person	Once exercised, applicable to **all** payment and receipt transactions Not limited to financial institutions No specific requirements with respect to customer	The option is exercised by means of a signed written declaration (in duplicate) stating the name, address and Belgian VAT number of the vatable person The Belgian VAT authorities will send one of the declarations back to the vatable person with a stamp and date of receipt	The normal VAT rules apply with respect to the taxable basis	Once exercised, the option is irrevocable	**Outgoing payment and receipt transactions:** Applicable to local and cross-border transactions (EU & non-EU) The vatable person will be entitled to deduct Belgian VAT with respect to cross-border payment and receipt transactions, even if the service is not subject to VAT in the EU Member State of the recipient **Incoming transactions**: A vatable person that has exercised the option should also pay VAT on its incoming payment and receipt transactions from foreign service providers located in Belgium under the general B2B rule	The big, and several medium-sized, banks in Belgium have opted to tax so as to optimise their right to deduct Belgian VAT mostly on IT costs. The option to tax is also used by payment factories established in Belgium There is no statistical data available on the use of the option to tax	N/A
BULGARIA	Option for taxation adopted to a very limited extent, i.e. for certain very specific financial services according to	Limited to the provision of credit for the supply of goods under lease arrangements (article 46, paragraph 2 from the Bulgarian VAT	May be applied to all or separate transactions at the discretion of the person providing the financing Not limited to	No formal declarations or notices are required to exercise the option	The normal VAT rules apply with respect to the	There are no provisions in the Bulgarian VAT legislation restricting revocation of the option to tax. In principle, when applying the option to	**Outgoing finance lease:** There is no guidance on whether the option to tax can be applied to cross-border leasing transactions, i.e. where the place of supply is outside Bulgaria	The option can be used by banks involved in financial lease transactions to optimise their partial VAT credit ratio. The banks in Bulgaria usually set up separate leasing	N/A

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
	article 135(1)b of Directive 2006/112/EC	Act)	financial institutions No specific requirements with respect to the customer The lessor has a right to deduct Bulgarian VAT incurred on purchase of the subjects of lease, subject to the usual documentary compliance requirements, irrespective of whether or not the option to tax is exercised		taxable basis	tax, it applies to the contract as a whole. Hence, once it has been applied to the financing element of a given leasing agreement, the option to tax could be irrevocable	The lessor has the right to deduct Bulgarian VAT incurred on purchase of the subjects of lease used for cross-border financial lease arrangements, even if the service is not subject to VAT in the EU Member State of the recipient According to guidance from the Bulgarian revenue authorities, exercise of the option to tax should be evidenced with an invoice on which VAT is charged. For example, in the case of a cross-border lease provided to a taxable person, the invoice should not show Bulgarian VAT because the place of supply in that case is outside Bulgaria. In view of this, VAT incurred on a cross-border leasing transaction, other than the VAT charged upon purchase of the subjects of lease, may be non-deductible	companies, which exercise the option to tax and recover most of the input VAT incurred on purchases The Bulgarian Lessors Association informed PwC that there is no statistical data available on the use of the option to tax	
CYPRUS	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	The Ministry of Finance is not considering adopting article 137(1)(a) of Directive 2006/112/EC in the near future PwC Cyprus has carried out a study for the Association of Cyprus Banks in which it has recommended

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
									adoption of the option to tax in Cyprus and has analysed the possible benefits that would come from this The initial response of the Ministry was positive. However, in view of current market conditions, no progress has been booked in this respect
CZECH REPUBLIC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DENMARK	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
ESTONIA	Option for taxation adopted for financial services according to article 135(1)(b) to (g) of Directive 2006/112/EC	All exempt financial services as listed in section 16(2[1]) of the Estonian VAT Act: (1) deposit transactions for the receipt of deposits and other repayable funds from the public; (2) borrowing and lending operations, including consumer credit, mortgage credit and other transactions for financing business transactions; (3) leasing transactions; (4) settlement, cash transfer and other money transmission transactions; (5) issue and administration of non-cash means of payment, inc. electronic payment	Option to tax may be exercised on a transaction-by-transaction basis Not limited to financial institutions No specific requirements with respect to customer	The option is exercised by means of a signed written declaration detailing the transactions for which the supplier wants to opt to tax There are no other formalities	The normal VAT rules apply with respect to the taxable basis	The supply for which the option to tax is exercised is subject to VAT for at least two years starting from the taxable event. As a result, the choice to opt is irrevocable for at least 24 months	Not applicable to cross-border transactions	The option is not widely exercised by credit or financial institutions Sometimes used in stock financing transactions There is no statistical data available on the use of the option to tax	N/A

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
		instruments, traveller's cheques, bills of exchange; (6) guarantees and commitments and other transactions creating binding obligations on persons; (7) transactions for their own account or for the account of clients in traded securities provided for in section 2 of the Securities Market Act and in foreign exchange and other money market instruments, including transactions in cheques, exchange instruments, certificates of deposit and other such instruments; (8) transactions and acts related to the issue, sale and purchase of securities;							
		(9) money broking; (10) negotiation services related to the services specified in clauses (1)–(9) of this section; (11) management of investment funds provided for in the Investment Funds Act and other investment funds of a contracting party to the EEA Agreement and subject to financial supervision, inc. the							

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
		provision of services related to the management of funds to the funds in the case of transfer of duties of a management company							
FINLAND	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
FRANCE	The scope of the option is widely defined by a legal provision. However, another provision explicitly excludes from that scope a series of transactions or of kinds of transactions	The option applies to transactions relating to banking and financial activities and, in general, to trading in securities and money (article 260B of the French VAT Code) The option can be applied by banks and other financial institutions, as well as other entities whose main business is to carry out financial or banking transactions Several financial services are excluded from the scope of the option such as foreign exchange transactions, commissions received upon issue of securities and bonds, consideration assimilated to interest and agio and transactions subject to Insurance Premium Tax	Once exercised, applicable to **all** transactions eligible for the option Limited to banks and other financial institutions, as well as other institutions whose main activity is to carry out financial or banking transactions No specific requirements with respect to customer	The option is exercised by means of a letter to the relevant tax office It is applicable as from the first day of the month following that during which the option is exercised and is valid for a period of five years	The normal VAT rules apply with respect to the taxable basis	The option can be revoked as from 1 January of the fifth year following that during which the option is exercised	**Outgoing transactions:** Applicable to local and cross-border transactions (EU & non-EU) The vatable person can deduct French VAT on cross-border banking and financial transactions, even if the service is not subject to VAT in the EU Member State of the recipient **Incoming transactions**: A vatable person that has exercised the option is not liable to French VAT on banking and financial transactions received from foreign service providers	The trend is that: - the big retail banks have revoked the option whilst the medium-sized banks prefer to keep the option, - financial intermediaries tend to keep the option, - management companies have rather revoked the option. As this is only a trend, we cannot rule out that certain service providers have not followed it due to e.g. the nature/location/VAT recovery position of their clientele or the intensity of competition in their market There is no statistical data available on the use of the option to tax	N/A
GERMANY	Option for taxation adopted for financial services	Exempt financial services including negotiation (except management of	Option to tax exercised on a transaction-by-transaction basis	No formal declarations or notices are required for	The normal VAT rules	The option to taxation and the revocation must be exercised no later than the time the	**Outgoing transactions:** If the service rendered is deemed to be carried out in another EU Member	Especially, local savings banks and cooperative banks use the option to tax for optimisation of	N/A

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
	according to article 135(1)(b) to (f) of Directive 2006/112/EC Not applicable for insurance transactions according to article 135(1)(a) of Directive 2006/112/EC and management of special investment funds according to article 135(1)(g) of Directive 2006/112/EC	investment funds and insurance transactions including the negotiation of insurance transactions)	Not limited to financial institutions The recipient must be a taxable person and the financial service must be used for his economic activity	exercising the option	apply with respect to the taxable basis	relevant annual VAT return is assessed and provided an appeal against the assessment can still be lodged	State, the supplier of the service is entitled to deduct input VAT under the following conditions: - if the service was deemed to be carried out in Germany, the supplier was able to opt for taxation - the VAT legislation of the other EU Member State also provides the possibility to opt for taxation for this supply of services - the customer has treated the supply of service as subject to VAT in the other EU Member State Please note that the above is based on a court case in the real estate sector. At this moment, there is no practical experience with regard to financial services in this respect **Incoming transactions in the case of non-resident suppliers:** It is possible to opt for taxation where the customer is a taxable person in Germany and the supplier is not established in Germany	their input VAT deduction (but only towards taxable persons with a right to deduct VAT) There is no statistical date available on the use of the option to tax	
GREECE	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
HUNGARY	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
IRELAND	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
ITALY	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
LATVIA	N/A	N/A	N/A	N/A	N/A		N/A	N/A	The Association of Latvian Credit Institutions has submitted a letter to the Ministry of Finance with request to review the possibility of implementing the option to tax in the National VAT Act, particularly in relation to credit card processing services
LITHUANIA	Option for taxation adopted to a limited extent, i.e. for certain very specific financial services according to article 135(1)(b) to (e) of Directive 2006/112/EC	The right to opt to tax is applicable to: - granting and negotiation of credit and the management of credit by the granter; - the grant and management of financial guarantees or other security for money by the granter; - the collection and management of deposits and other repayable funds, clearing services between banks, other services connected with the arrangement of settlements, money transfer, organisation of non-cash settlements, issuing letters of credit and transactions related to debts and debt obligations (with the exception of debt collection);	The option to tax is applied to a specified group of financial services for at least 24 months (not on a transaction-by-transaction basis) Not limited to financial institutions The option can only be applied to services supplied to taxable persons registered for VAT (not applicable to legal entities that do not perform any economic activities)	The option is exercised by means of a signed written notification to the local tax authorities no later than the 25th of the following month where the first time VAT is charged. However, the notification can be sent before the option to tax is exercised The notification should include the name, address, VAT number and contact details of the VAT payer, identification of the services and the date when the option is intended to be applied/has been applied The notification is confirmed (with the an official note) by the local tax	The normal VAT rules apply with respect to the taxable basis	The option to tax cannot be revoked within 24 months. Revocation is done by sending a signed written notification to the local tax authorities (following the same procedure as for the option to tax). Note that discontinuation of the VAT calculation is not treated as a revocation of the option to tax if the notification is not sent to the tax authorities	**Outgoing transactions:** Not applicable to cross-border transactions, applicable to local transactions According to a recent interpretation by the tax authorities, the Lithuanian taxable person that has exercised the option to tax for a specified group of financial services does not have a right to deduct input VAT with respect to services provided to a foreign taxable entity. However, this is not expressly stated in the VAT legislation **Incoming transactions:** No regulations on whether the taxable person that has exercised the option should have to account for VAT, following the general B2B rule to VAT	Banks in Lithuania have not opted to tax financial services The Lithuanian Ministry of Finance and the competent Tax Authorities informed PwC that there is no statistical data available on the use of the option to tax	N/A

Country	General remarks	Transactions envisaged	Application	Formalities	Taxable basis	Revocation	Treatment of cross-border transactions	Extent of use	Discussion for future implementation
		- currency transactions, accepting contributions in cash and disbursing payments, cash management and other services directly connected with bank notes and coins of any currency The right to opt to tax is not applicable to: - transactions, including negotiation, in securities; - management of special investment funds		authorities within 5 business days The first calculation of VAT on financial services (notwithstanding the fact that no notification to the tax authorities has been sent) is treated as an option to tax					
LUXEMBOURG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
MALTA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
NETHERLANDS	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
POLAND	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
PORTUGAL	N/A	N/A	N/A	N/A	N/A		N/A	N/A	N/A
ROMANIA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
SLOVAKIA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
SLOVENIA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
SPAIN	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
SWEDEN	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
UK	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

ENCLOSURE 15: OTHER TAXES COMPENSATING FOR THE GENERAL TAX EXEMPTION

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
AUSTRIA	**Insurance Premium Tax**	Insurance services rendered by an insurance company to a customer for which the insurance company receives a premium, if the insured risk is deemed to be in Austria	No specific comments	The Insurance Premium Taxes are to be reported on the annual Insurance Premium Tax Return which has to be filed annually with the Austrian tax authorities However, the Premium Taxes are due (have to be paid to the Austrian tax authorities) by the 15th of the second following month in which the premiums were paid	The insurance premiums received by the insurance company Fire insurance premiums at a rate of 8%; life insurance premiums at a rate of 4-11%; premiums for old age pension at a rate of 2,5%; health insurance premiums at a rate of 1%; all other insurance premiums at a rate of 11%; motor vehicle tax (EUR 0,6 per kilowatt, at least EUR 6 per month)	N/A
	Stamp Duty	- security declaration ("Bürgschaft") - the cession of accounts	No specific comments	The legal transaction has to be notified to the Austrian tax authorities by the 15th	- the value of the warranted payable (at a rate of 1%)	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		receivable or other rights - the issuance of bills of exchange		of the second following month in which the Stamp Duty liability has occurred	- the consideration paid (at a rate of 0,8%) - the value of the bill of exchange (at a rate of 0,125%)	
	Bank Levy **(as from 1 January 2011)**	Financial institutions with a concession according to the Banking Act (BWG) as well as registered branches of EU/EWR financial institutions, which are allowed to offer services in Austria according to the Banking Act (BWG) without a concession, are within the scope of this levy	No specific comments	A tax return has to be filed by October 31 of the year concerned (i.e. for 2011 October 31, 2011) Quarterly prepayments are required (the first one due by January 31, 2011)	The average unconsolidated balance sheet total (with certain adaptations) Between EUR 1 and 20 billion the tax rate is 0,055% , above 0,085% An exemption applies if the balance sheet total is below EUR 1 billion	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	Bank Levy for Derivatives **(as from 1 January 2011)**	Financial institutions with a concession according to the Banking Act (BWG) as well as registered branches of EU/EWR financial institutions, which are allowed to offer services in Austria according to the Banking Act (BWG) without a concession, are within the scope of this levy	No specific comments	A tax return has to be filed by October 31 of the year concerned (i.e. for 2011 October 31, 2011) Quarterly prepayments are required (the first one due by January 31, 2011)	The average volume of derivatives in the trade book (at a rate of 0,013%)	N/A
BELGIUM	**Annual Tax on Insurance Operations** **The standard Belgian Insurance Premium Tax is set to 9,25%.**	Insurance operations are subject to an annual tax if the insured risk is located in Belgium. If the insured person is a legal entity, the risk is in any case considered to be located in Belgium when the insurance contract relates to an	Always applicable unless explicitly exempt under Belgian Insurance Premium Tax legislation (e.g. relating e.g. to reinsurance contracts, pensions, insurance contracts with the	As a rule, the insurance company is liable to collect the tax and make the payments to the Belgian tax authorities The Insurance	Insurance Premium Tax is levied on the gross premium. (i.e. on the total of the premiums and contributions, increased by the costs payable or to be suffered during the year by the insured,	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	However, reduced tax rates exist (4,40%, 1,40%, 1,10%) for certain types of (both life and non-life) insurance contracts	establishment of this legal entity situated in Belgium (i.e. the main establishment of the legal entity or any other permanent presence of this legal entity, whatever its form) In practice, applies to transactions which are exempt of VAT	Belgian State and certain eligible public entities, ...)	Premium Tax has normally to be paid by the liable person at the latest on the last working day of the month following the month during which a premium, a personal contribution or an employers' contribution fell due An advance payment of the Insurance Premium Tax is due each January and can be paid as from the 15th December preceding the month of January. This advance payment amounts to the Insurance Premium Tax paid in November of the current year	the beneficiary or the employer)	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	National Sickness and Invalidity Institute parafiscal contribution **Motor vehicle insurances (10% or 5%); Fire risks and related risks (6,56% out of which 0,06% is borne by the insurer), Motor vehicle insurances (7,56% out of which 0,06% is borne by the insurer), and Insurances against accidents at work (5,03% out of which 0,06% is borne by the insurer); Additional hospitalization insurance (10%);**	Insurance operations linked to specific risks (e.g. car insurance, fire risks insurance, etc.) when the risk is located in Belgium (basically, same rule as for the Insurance Premium Tax) In practice, applies to transactions which are exempt of VAT	Parafiscal contributions are cumulative with each other and with the Insurance Premium Tax	The insurer itself has to declare and pay the taxes or, in the case of free provision of a service from abroad, the sub-office, agency, the place of business, insurance broker, fiscal representative, etc.	On the premium paid by the insured person when taking out an insurance policy	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	Allowance of complementary financial means to the Belgian Red Cross (0,35%) **Additionally: Tax to subsidize the Security fund for fire prevention and fire control (3%)**					
	Tax on Stock Exchange Transactions **(various rates applicable 0,07%; 0,5%; 0,17%; subject to a tax ceiling of EUR 500 or EUR 750 per transaction)**	The tax is due on the following transactions concluded or executed in Belgium through a Belgian professional intermediary to the extent that they relate to public funds, irrespective of their (Belgian or foreign) origin: - every sale, purchase and, in general, every transaction for valuable consideration (secondary	The tax is not due if no Belgian intermediary acting in the course of its business intervenes in the deal. There are also specific exemptions (e.g. transactions made for its own account by some	The Belgian professional intermediary is liable to pay the stamp duties to the competent Belgian tax authorities (payment at the latest on the last working day of the month following the month during which the transaction was executed)	The tax is due: - for acquisitions or purchases, on the sums to be paid by the purchaser after deduction of the brokerage commission - for sales, on the sums to be received by the seller or assignor, without deducting the brokerage commission	Increase of the tax rates and/or removal of the tax ceilings

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		market transactions); - every redemption of its own shares by an investment company provided that the redemption relates to accumulating shares. In practice, applies to transactions which are exempt of VAT	financial institutions, such as banks, insurance companies, etc…; transactions made for its own account by non-resident taxpayers).	On the day of the payment also a special form has to be filed with the same Belgian tax authorities in which all the elements for the calculation of the stamp duties should be mentioned	- for redemptions of own accumulating shares by a Sicav, as a rule, on the net asset value, without any deduction of lump sum charges	
BULGARIA	**Tax on Insurance Premiums at 2% flat rate** **(as from 1 January 2011)**	With Tax on the insurance premiums are taxed the insurance premiums received under taxable contracts As taxable contracts are considered all insurance contracts covering risks located in Bulgaria under the insurance legislation, except for the contracts	The tax on insurance premiums is to be applied upon the receipt of premium payments by the insurer Insurers have to pay the tax due on a monthly basis by the end of the month following the month	Insurers have to file a declaration to the revenue authorities on a quarterly basis by the end of the month following the respective quarter Foreign insurers who will provide insurance services covering risks located in Bulgaria	The taxable base is the insurance premium, received by the insurer under the taxable contract In case of deferred payment of the premium, the taxable base is each instalment received by the insurer	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		for: - reinsurance and retrocession - life insurance and annuity - marriage and child insurance - life insurance related to investment funds - permanent health insurance - acquisition of equity - additional insurance for permanent/temporary loss or reduced working capacity as a result of an incident or an illness, for work incapability as a result of injury, for hospitalization, for a heavy illness or medical	for which the tax is due. Where insurance premiums for which insurance premium tax has been paid are reimbursed, the insurance companies are entitled to a refund of the tax paid on the returned premium.	under the rules for free provision of services have to register with the Bulgarian revenue authorities or appoint a local fiscal representative, where the local representative will be jointly liable for any liabilities of the insurer under the Insurance Premium Tax Act The fiscal representative or the insurer who provides insurance services under the rules for free provision of services (if the latter does not appoint local fiscal representative) should also file a one-off declaration for the first month for which tax is	The taxable base is to be reduced with the amounts which the insurer should attribute to the obligatory guarantee funds as per the local insurance legislation The taxable base does not include the bonuses and discounts from the insurance premiums provided to the insured person upon the payment of the premium	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		expenses - insurance of aircrafts and vessels, as well as the civil liability insurance related to them - international cargo insurance where the starting and the end points of the transportation are outside Bulgaria		due by the end of the following month		
CYPRUS	**Life Insurance Premium Tax**	Life insurance contracts	The income tax calculation of life insurance companies is carried out under the normal corporation tax rules and rates but also based on the life insurance Premium Tax at the rate of 1,5% on the gross premium	The payment of the Life Insurance Premium Tax is done in the same way as corporation tax	Gross premium deriving from life insurance contracts	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
			The Premium Tax is set off against the income tax as calculated based on the normal tax rules and rates and the difference/excess, if any, is paid to the Treasury			
CZECH REPUBLIC	N/A	N/A	N/A	N/A	N/A	Insurance Premium Tax may be implemented in the Czech Republic as of 2013
DENMARK	**Special Payroll Tax**	Most VAT exempt activities, including VAT exempt financial activities, are liable to a Special Payroll Tax	Applicable to all companies having VAT exempt financial activities Not limited to banks and insurance companies	The company must register for this Special Payroll Tax	Financial services companies (or companies whose main activity is financial services) must pay the highest tax rate, namely 10,5 % of the payroll related to VAT exempt activities. The taxable	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
			Also branches and representative offices are liable if they have employees in Denmark		base will as a main rule include all payroll and all taxable benefits The supply of services subject to VAT are not subject to the Special Payroll Tax. This means that if employees are engaged in both VAT taxable and VAT exempt activities, the Payroll Tax should only be applied according to the time usage related to VAT exempt activities. Most commonly it is not possible to specify this time usage and therefore the taxable base should be estimated. In practice this estimation could be equal to the inverse fraction of the	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					calculated pro rata VAT recovery right. However, payroll used for financial transactions to customers outside the EU will also be liable to the Special Payroll Tax	
	Insurance Premium Tax regime regarding automobiles, yachts and floodings	Insurance contracts regarding automobiles, yachts and floodings	Applicable to insurance companies	Danish and foreign companies (local representative needed)	Yachts: 1 % of the yearly insurance amount Automobiles: main rule 42,9 % of the liability insurance premium Floodings: 30 DKK (4 Euro) each year per insurance	N/A
	Stamp Duty	General insurance contracts concluded in Denmark and general	It is the insurance contract that is liable	Each part of the insurance contract is	The Stamp Duty for general loss and damage insurance is	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		insurance contracts if the risk is placed in Denmark	to the Stamp Duty	liable to the Duty	calculated as 0,0058 % of the insured amount *or* as 14 % of the insurance premium	
ESTONIA	N/A	N/A	N/A	N/A	N/A	N/A
FINLAND	**Insurance Premium Tax**	Tax is payable when the insured assets are in Finland or the insurance relates to activities taking place in Finland	Certain insurance contracts are not covered by Insurance Premium Tax	Monthly returns and payment of the Tax	Tax rate is 23 % from the insurance payments in which the Tax is not included	N/A
FRANCE	**Payroll Tax**	Not applicable to transactions but paid by a French-established employer on the salaries (progressive in accordance of salary threshold) to the extent that its turnover is either VAT exempt (without credit) or outside scope of VAT In this respect, the	Payable on the salaries paid in year N on the basis of the Payroll Tax prorata of calendar year N-1 There is a threshold of VAT exempt /outside scope of VAT revenue and conditions under which the business would not be liable to	None except special form and payments on a monthly basis to be regularized the following year	Salaries as defined for social security purposes	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		Payroll Tax is apportioned on the basis of the following ratio: **Numerator**: the VAT exempt and the outside scope of VAT revenue, and **Denominator**: the total revenue (taxable, VAT exempt and outside scope of VAT)	Payroll Tax			
	Insurance Premium Tax	Insurance contracts concluded with a insurance company; either French or foreign, wherever the place where, and the date when it was concluded Certain insurance contracts are Insurance Premium Tax-exempt such as life insurance, group insurance,	Insurance Premium Tax is due at the time when the payment of premium or of contribution by the insured becomes due	Paid on a monthly basis by the insurer. Foreign insurers have to appoint a representative The insurer, intermediaries and insured persons are jointly liable to pay the Tax	The consideration paid for the benefit of the insurer (premium, contribution, ancillary payments by the insured, etc.) The insurer, intermediaries, brokers and insured persons are jointly liable to pay the Tax	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		insurance covering a risk located outside of France, etc. Various rates apply depending on the nature of the risk (from 7% for health insurance to 30 % which is the main rate for fire insurance through 9, 18, 19 and 24% for other types of insurance)				
GERMANY	**Insurance Premium tax and Fire Brigade Tax:** if subject to such tax, the insurance is exempt from VAT (as a general rule)	Insurance Premium Tax is a transaction tax linked to remuneration for the provision of insurance cover, i.e. insurance transactions. A key issue is determining whether an insurance transaction actually exists, as even remuneration for certain sureties and guarantees can be subject to Insurance Premium Tax	Always applicable unless explicitly exempt under German Insurance Premium Tax Law	Separate registration for Insurance Premium Tax and Fire Brigade Tax with the Federal Central Tax Office (Bundeszentralamt für Steuern) In first year returns to be submitted and tax to be paid quarterly, for following years	For Insurance Premium Tax: taxable base is generally the net insurance premium, different tax bases apply for some types of insurance; standard Insurance Premium Tax rate is 19%, different rates apply for some types of insurance	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		The exact Insurance Premium Tax treatment of an insurance transaction will depend on the location of the insurer with which the contract is concluded and the location of the policyholder. As a general rule for insurance contracts concluded with EU insurers the EU principle of risk location states that Insurance Premium Tax shall be exclusively levied in the EU Member State in which the insured risk is situated. For non-EU insurers the Insurance Premium Tax treatment depends on the location of the policyholder or the location of the insured object		monthly returns may have to be submitted if certain thresholds were exceeded in the previous year Returns to be submitted and tax to be paid by the 15th of the month following the end of the reporting period Person responsible for submitting the return (insurer, Insurance Premium Tax representative or policyholder) depends on whether the insurer is located in the EU or has an Insurance Premium Tax representative in the EU; an Insurance	For Fire Brigade Tax: taxable base is a percentage of the insurance premium (depends on type of insurance); standard Fire Brigade Tax rate is 19%, for certain types of fire insurance 22%	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		Certain types of insurance transaction are exempt from Insurance Premium Tax, e.g. life insurance, reinsurance Fire Brigade Tax is only payable for certain types of insurance transactions covering fire risks and which are also subject to Insurance Premium Tax Insurance Premium Tax is ultimately borne by the policyholder; Fire Brigade Tax is borne by the insurer		Premium Tax representative in Germany is not mandatory		

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
GREECE	**Stamp Duty** **Levied on documents - accounting entries are equivalent to documents**	Only on documents concluded and executed in Greece, such as : - loan agreements between legal entities (neither of which is a bank) or between an individual and a corporate entity (not a bank) - deposits to corporate non-banking entities by the shareholders - debt recognition or debt assignment	Limited to loans concluded and executed in Greece provided by non-banking entities Specific exemptions apply (mainly pertaining to the territoriality principle)	Stamp Duty is due within five days starting from the agreement date The person liable to pay the Stamp Duty is to be determined freely by the contracting parties. In the case of non-payment, both parties are jointly liable against the State	For loans: the principal and interest amount of the loan paid For other transactions falling within the scope of Stamp Duty: the amount of the transaction (in certain cases the value of charges may be deducted) Stamp Duty rates: 2% for commercial transactions (e.g. loans concluded between	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		- assignment of receivables Collateral agreements to transactions that fall within scope of VAT are exempt from stamp duties No stamp duty is imposed with respect to the acquisition or disposal of shares or other securities			non-banking corporate entities) 3% for private transactions 1% for other transactions specifically provided for in the Stamp Duty law (e.g. deposits to corporate entities by the shareholders) The Stamp Duty amount is increased by a 20% contribution (surcharge) collected in favour of the Insurance Organization for Farmers	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	0,15% Stock Exchange Transaction Duty **Duty will increase to 0,2% for listed share transactions effected up to 31 December 2011 based upon new Tax Bill which is expected to be ratified by the Parliament. Transaction Duty will be abolished as from 1 January 2012**	Sale of listed shares	Transfer of listed shares either in the Greek Stock Exchange or in foreign Stock Exchanges acquired by Greek tax residents (individuals or legal entities)	Greek listed shares: 0,15% is withheld by the Greek Stock Exchange Foreign listed shares: 0,15% is paid by the beneficiary to the respective Tax Office within the first 15 days of the month following the one the shares have been sold	Sale price of the listed shares	N/A
	0,6% Special Contribution of L. 128/75	Loan and credit agreements	Limited to loans and credits extended by Greek or foreign credit institutions to Greek companies or individuals liable to tax reporting in	For loans extended by Greek banks: contribution is paid directly by the banks to the Bank of Greece	Total amount of loans and credits	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
			Greece	For loans extended by foreign banks: contribution is paid by the borrower through a monthly return submitted to the competent Tax Office on the last day of each month		
	Insurance Premium Tax	Insurance agreements	Limited to insurance contracts concluded in Greece	Insurance Premium Tax is rolled over to the policyholder and attributed to the Greek State by the Insurance Company, by submitting Insurance Premium Tax returns	Gross premiums The rates vary depending on the risks covered: - 4% for life insurance premiums (but is levied only for contracts with duration of less than ten years) - 20% for fire insurance premiums -10% on all other	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					insurance premiums	
HUNGARY	**Special Tax on Financial Organizations - General description**	On 22 July 2010, the Hungarian Parliament passed the Bill on the special Tax (or "Bank Tax", as it is generally known), which is payable by a wide range of financial organizations. The various financial organizations will have to use different methods to calculate the special Tax (tax base and rate). The Government expects a sum of 187 billion HUF income for 2011 and plans to reduce it by half over the subsequent 3 years		The special Tax for 2011 must be self-assessed and reported by 10 Match 2011, and then paid in four equal instalments. Financial organizations shall pay the Tax quarterly, by the tenth day of the last month of the quarter in question. The special Tax has to be declared on a standard form that the Tax Authority designates for this purpose		N/A
	Special Tax on Financial Organizations - Credit institutions				For credit institutions, the special Tax base is the adjusted balance sheet total calculated from the figures of the 2009 financial statements. The definition of the adjusted balance sheet total is very detailed and is included in the Act. The adjusted balance sheet total is the balance sheet total	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					reduced e.g. by the following items: receivables that arise from domestic inter-bank lending, the amount of debt instruments and shares issued by other domestic credit institutions, financial enterprises and investment enterprises, receivables that arise from loans, subordinated loan capital and additional subordinated loan capital provided to domestic financial enterprises and investment enterprises (including receivables that arise from genuine sale and repurchase transactions, from custody repurchase transactions and from specified delivery repurchase	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					transactions), as well as debt instruments issued by credit institutions in the Either Tax rate is 0,15% of the part of the Tax base that does not exceed HUF 50 billion, and the part of the Tax base above HUF 50 billion is taxed at 0,53%	
	Special Tax on Financial Organizations - Insurance companies				For insurance companies, the special Tax base is the adjusted fee calculated from the figures of the 2009 financial statements. The adjusted fee is the amount of the premiums earned from non-life insurance business without re-insurance, plus the gross premium earned from life insurance business, minus 90%	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					of the insurances with single premiums and 90% of the ad-hoc premiums, and minus the amount of certain premiums of pension supplement insurances with payment at a later stage. Below 1 billion HUF, the rate will be 1,5%, below 8 billion HUF it will be 3% and above 8 billion HUF it will be 6,4%	
	Special Tax on Financial Organizations - Financial enterprises				For financial enterprises, the special Tax base is the interest income, and the income from fees and commission based on the figures of the 2009 financial statements. The Tax rate is 6,5% of the Tax base in both cases	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	Special Tax on Financial Organizations - Investment enterprises, stock exchanges, commodities exchange service providers and venture capital fund managers				The Act specifies different methods for calculating the Tax base for investment enterprises, stock exchanges, commodities exchange service providers and venture capital fund managers. In all cases, the Tax base is determined on the basis of definitions of adjusted revenue, and the Tax rate is 5,6%	
	Special Tax on Financial Organizations - Investment fund managers				For investment fund managers, the Tax base is the total amount of net asset value of funds managed as of 31 December 2009 and the value of financial funds and other portfolio assets managed as of 31 December 2009. The Tax rate is 0,028% of the Tax base	
	Special Tax on Credit Institutions	A new special Tax on credit institutions has been added to the general Bank Tax, which amounts to 30% of the profit. This sum will be deductible from the Bank Tax, which is paid on the basis of the 2009 balance sheet total. The aggregate amount of the Tax and the balance sheet based Tax cannot exceed the Tax calculated on the basis of the balance sheet				N/A
	Tax Liability of Credit Institutions ('Bankers Contribution')	Credit institutions shall assess and pay Bankers Contribution at the rate of 5% on their interest and similar income earned during the Tax year from loans which are directly or indirectly		Credit institutions shall pay the Bankers Contribution advance on interest and similar income earned quarterly, by the twelfth day of the month following the quarter in question,		N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		affected by any interest subsidy or interest compensation system (including the interest rate subsidies provided to loans secured by mortgage in accordance with specific other legislation), shown under interest paid and similar charges in accordance with specific other legislation on loans which are directly or indirectly affected by any interest subsidy or interest compensation system, less any interest margin due and payable to the Hungarian State. By way of derogation from the above, the Contribution on subsidized interest rates shown by the mortgage loan company under income shall be paid by the credit institution to which financing was provided, if the mortgage loan company notifies the credit institution of the sum payable in writing		where the Bankers Contribution advance for the last quarter shall be due by the twentieth day of the last month of the tax year		
	Fire-protection Contribution	Applicable to insurance companies		The Contribution is payable quarterly: on the 30th day of the next month after each quarter	The premium-income of the insurance company from certain types of insurances defined in the corresponding law. The Contribution has to be determined by calculating the 1,5% of the premium	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					income earned on a number of types of insurance-products	
IRELAND	**Stamp Duty**	Non-life insurance policies	The Duty arises were the premium is greater than EUR 20 were there is one premium only or, were there is more than one premium payable, and the total amount payable in respect of that premium in any 12 month period exceeds EUR 20. There are certain exemptions to this provision, for example in respect of certain health insurance contracts	A composition agreement is usually put in place with Revenue to deal with the EUR 1 duty on creation of a policy of insurance	A EUR 1 charge to Irish stamp duty arises in respect of policies of insurance (other than life insurance) where the risk to which these policies relate is located in Ireland	N/A
	Government Levy	Non-life insurance premiums	A 3% levy is imposed on the gross amount of premiums received by an insurance company on certain	Quarterly returns are required to be made in respect of this Levy	Gross amount of premiums	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
			non-life insurance premiums written in respect of risks located in the State. Key exemptions are reinsurance, voluntary health insurance, marine, aviation, transit insurance, export credit insurance and certain dental insurance contracts			
	Government Levy	Life assurance premiums	A 1% levy is imposed on life assurance premiums. It is levied on the gross amount received by the insurer by way of premium to the extent to which the risks to which those policies relate are located in the State or deemed to be located in the State	Quarterly returns are required to be made in respect of this Levy	Gross amount of premiums	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	Government Levy	Health insurance levy	The Finance Bill 2011 contains two amendments in relation to the Levy payable by health insurance providers. The Levy has been increased for all renewals and new contracts entered into from 1 January 2011 to EUR 66 (from EUR 55) for each insured person aged less than 18 years and EUR 205 (from EUR 185) for each insured person aged 18 years or over	The due dates for payment of the Levy have also been brought forward from 30 September 2011 and 31 January 2012 to 21 September 2011 and 21 January 2012 respectively	Lump sum	N/A
ITALY	**Stamp duty**	Bank, securities and credit card statements	The Stamp Duty is due based on documents filed	Tax is paid trough the application of a stamp on the document or, alternatively, in "virtual way" (on a yearly basis) by following a special procedure	Depending on the recipient (individual or company) and the frequency of issuance of the statement (annual, per semester, quarterly, monthly)	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					Stamp Duty on credit card statement is due on a fixed amount of EUR 1,81 Stamp Duty on financial bills is due at 1% rate, draft bills are subject to 1,2% rate	
	Substitute Tax on Medium/Long Term Loans	Loans having a duration of more than 18 months (medium/long term loans) granted by the banks for transactions territorially relevant in Italy special rules apply for specific sectors (agricultural credit, handicraft credit, etc.)	At the date of drawing up the loan	The bank is required to submit to the authorities a tax return by the end of March, declaring the amount of loans granted and the Tax due The payment of Substitutive Tax is due within 30 days from the filing of tax return	0,25% (with regard to loans related to the purchase of a second-home the percentage is increased up to 2%)	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	Registration Tax	Medium/long term loan carried out by non-banks	At the date of registration	Payment through F23 Form	Fixed amount of EUR 168 when the lender is subject to VAT 3%, if the loan is granted by individual 0,50% on any guarantee on the loan allowed by third parties	N/A
	Mortgage Tax	Mortgage loans granted	Date of mortgage deed	Payment through F23 Form	2% (and 0,5% for the cancellation)	N/A
	Registration Tax	Transfer of securities registered to the authorities (so called registration of the agreement in case of "use")	At the date of registration	Payment through F23 Form	Fixed amount of EUR 168	N/A
	Registration Tax	Loans granted trough	At the date of	Payment through F23	0,50%	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		transfer of debts	registration	Form		
	Insurance Premium Tax	Insurance policies offered to Italian clients	At the date of collection of the premium	Payment is due by the insurer, through F23 Form by the month following the collection of payment Tax return has to be filed to the Italian authorities to declare premiums collected and Insurance Premium Tax paid	Rate ranging from 0% up to 21,5%, depending on the nature of the risk No Insurance Premium Tax is due on life insurance policies, unit-linked policies and capitalization policies	N/A
LATVIA	**Bank Levy of 0,036%**	The Duty is imposed on the taxpayer's total liabilities at the end of the tax year as reduced by the total of: - the deposits which are subject to the deposit guarantee system in Latvia and other EU Member States	The Duty is levied on the Latvian credit institutions, their foreign branches, and also on the Latvian branches of foreign credit institutions Electronic money institutions (the	The Duty is chargeable on an annual basis (for a calendar year), in four quarterly advance payments equalling ¼ of the annual charge of the Duty		N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		- the mortgage bonds issued by the credit institution - the subordinated liabilities reported as subordinated capital in the equity capital calculation of the credit institution under the requirements of the Financial and Capital Market Commission	undertakings, other than banks, which are issuing and servicing e-money) are not subject to the Duty			
LITHUANIA	N/A	N/A	N/A	N/A	N/A	N/A
LUXEMBURG	**Insurance premium Tax**	Insurance contracts	Applicable on all insurance contracts except on life-insurance and re-insurance contracts	Insurance Premium Tax is paid to the authorities by submitting Insurance Premium Tax returns	Insurance premium	N/A
	Registration Duty	- life insurance contracts - bill to order - certificate of debt	The percentage of Registration Duty due on these transactions ranges from 0,24% to 1.2%	Registration Duty is payable at the time the contract is presented for voluntary registration to the	Regarding the life insurance contracts the Registration Duty is levied on the value of the capital insured. For	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		- bankable bill - transfer of debt - acknowledgement of debt		registration office. No Duty is payable if the contract is not registered. There is no specific form used to declare the amount payable. Depending on the type of transaction to be registered, the deadline for registration may differ	other acts, on the amount declared at the time of the registration	
MALTA	**Stamp Duty in terms of the Duty on Documents and Transfers Act (Chapter 364 of the Laws of Malta) (the Act)**	Duty is chargeable on the following insurance contracts: policies of life insurance which are not renewable every year, policies of insurance, that are not life insurance policies, endorsements of insurance policies if the effect thereof is to make certain prescribed alterations to the existing policy No Duty is chargeable on	The transactions constitute documents chargeable with Stamp Duty upon their origin for the purposes of the Act, which are subject to Duty either from the origin of the document if it is executed in Malta or by reason of its use if it is executed outside Malta. A document executed outside Malta is deemed to be made use of in Malta,	Any person issuing or signing the policies of insurance referred to herein are bound to pay Duty	The taxable base with respect the policies is as follows: - policies of life insurance: a Duty of ten cents for every one hundred Euro or part thereof of the sum assured - non-life insurance policies: a Duty of ten	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		policies of insurance in respect of aviation, marine cargo, marine hull or boat, credit and suretyship and medical cover. Duty on policies relating to risks as defined in the Insurance Business Act is restricted to risks situated in Malta	where it is produced before a Court, arbitrator or referee as evidence or is produced before any person or authority in Malta for its enforcement or registration. Duty with respect to the latter type of policies should be paid before use thereof is made in Malta		cents for every Euro or part thereof of the agreed yearly premium or if a compounded premium is agreed upon as a lump sum payment, or a once only premium is otherwise payable, then of the agreed consideration. The same amount of Duty applicable to non-life policies is payable upon endorsements of policies as an endorsement is deemed to constitute a new policy to the extent that the alteration in the policy has the effect of altering the person or thing insured, the risks insured or the duration of the policy. Duty of two euro and thirty-three cents is payable upon any other	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					endorsement	
THE NETHERLANDS	**Insurance Premium Tax**	- The insurance is supplied to a Dutch legal person, - the risk is located in the Netherlands, and/or - the goods insured (such as an automobile) are located in the Netherlands	The following are exempt from Insurance Premium Tax: - life insurance - accidents, infirmities and incapacity for work insurance - medical insurance - unemployment insurance - insurance of sea ships and aircraft	There are registration requirements with associated Insurance Premium Tax return requirements	The taxable amount for Insurance Premium Tax purposes is the insurance premium payable including any amount payable for the insurance related services. The tax rate is 9,7% as from 1 January 2011.	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
			- transport insurance - reinsurance - export credit insurance			
POLAND	N/A	N/A	N/A	N/A	N/A	There are discussion about a Bank Tax. However the possibility that it will be implemented is rather low Other planned changes are: - Extension of the Capital Gains Tax. Nowadays, the Capital Gains Tax does not concern some of the bank deposits with the daily capitalization

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
						of interest. It is planned that the said Tax will also be levied on these types of banks' deposits - Taxation of the assets of certain financial institutions. The taxable base of those financial institutions will be the institution's total assets indicated in the approved annual financial statement. The tax rate is expected to be 0,39% tax base
PORTUGAL	**Stamp Duty**	Financial transactions VAT exempt	Financial transactions VAT exempt	Payable by the 20th of the month following the taxable event	Different rates (between 0,04% and 4%) apply depending on the financial transaction, e.g.	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					granting of credit: 0.04% to 1% current account: 0.7% interest: 4% commissions: 3%	
	Stamp Duty	Insurance	Insurance contracts	Payable by the 20th of the month following the taxable event	5% to 9%	N/A
	FAT **Labour Accidents fund**	Insurance	Labour	Payable by the end of the month following the taxable event	0,15%	NA
	SNB **National Fireman Service**	Insurance	Agricultural, automotive, livestock, fire, multi-risks, transport of goods, boats and aircraft	Payable by the end of the second month following the taxable event	6% to 13%	N/A
	INEM	Insurance	Labour, personal, automotive, health,	Payable by the end of the second month	2%	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
	National Medical Emergencies Institute		life	following the taxable event		
	ISP **Portuguese Insurance Body**	Insurance	Insurance contracts	Payable by the end of January and July, on the policies issued on the previous 6 months	0.048% to 0.242%	N/A
	FGA **Automotive Insurance Fund**	Insurance	Automotive	Payable quarterly in the first month of each quarter on the policies issued on the previous year	2,50%	N/A
ROMANIA	N/A	N/A	N/A	N/A	N/A	Further to the latest discussions held by the Romanian political parties, there was an intention of introducing a Tax for financial transactions, but no actual measures were taken in this respect so far

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
SLOVAKIA	N/A	N/A	N/A	N/A	N/A	N/A
SLOVENIA	**Insurance Premium Tax**	Insurance	Non recoverable Tax Are exempted from the Tax: life insurance and health insurance policies of more than ten years duration, pension contributions, disability insurance, reinsurance and insurance outside Slovenia	Payable by insurance companies	Flat rate of 6,5% of insurance premiums	N/A
SPAIN	**Insurance Premium Tax (introduced for premiums payments from 1st January 1997)**	According to the Spanish Insurance Premiums Tax Law, premiums paid by Spanish residents are subject to this tax. Nevertheless, the following kinds of insurance are exempt from Insurance Premium Tax as established by the	Compulsory	N/A	The taxable basis is the total premium paid by each policy holder (not including any other surcharge levied on it), being the tax rate of 6%. The taxpayer is the insurance company, but it must recharge	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		Law: - the operations relating to mandatory social security and group insurance contracts which implement the pension commitments assumed by the employers in the terms provided for in the First Additional Provision of Royal Decree 1/2002 on the Regulation of Pension Schemes and Funds. That is, group insurance contracts which cover the contingencies of retirement, disability and death - the operations relating to life insurance contracts - the capitalisation			the Tax to the policyholder. The Tax is accrued when premiums are paid (in case of partial payments, the Tax is accrued when each of them takes place)	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		operations based on actuarial techniques - the reinsurance operations - the surety insurance operations - the export credit insurance and combined agricultural insurance operations - the insurance operations connected with international freight or passenger transport - the insurance operations connected with ships or airplanes for international transport, except for those used for the purposes of private recreational navigation or aviation - the healthcare and				

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
		medical insurance operations - the operations relating to private welfare schemes insured (which are known in Spain as "planes de previsión asegurados")				
SWEDEN	**Traffic Insurance Tax**	Tax on traffic insurance premiums for vehicles	All motor vehicles used on road except lorries	Paid via the premium to the insurance company	32% of the insurance premium	N/A
THE UK	**Insurance Premium Tax**	A premium received by an insurer if the premium is received under a taxable insurance contract Certain fees charged by intermediaries under a higher rate contract	Insurance Premium Tax is payable by the insurer and taxable intermediary	Insurers receiving taxable premiums and taxable intermediaries are liable to register for Insurance Premium Tax and file Insurance Premium Tax returns on a quarterly basis	General insurance premiums, but not long term insurance, reinsurance and insurance of some commercial goods which are exempt from Insurance Premium Tax From 2011, standard rate 6% and higher rate of 20% (in line	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					with VAT rate) for travel insurance and some insurance for vehicles and domestic/electrical appliances	
	Bank Levy **(Commences for accounting periods ending after 1 January 2011, awaiting Royal Assent)**	Levy based on the liabilities on balance sheet of banks subject to some exclusions Applies where the chargeable liabilities are greater than £20 billion	UK banks, banking groups and building societies on their worldwide profits Foreign banking groups operating in the UK through permanent establishments or subsidiaries, on their UK operations UK banks and banking sub-groups in non-banking groups	Paid in quarterly instalments, at the same time as corporation tax is paid	No levy on the first £ 20 billion of chargeable liabilities (apportioned to long and short maturing liabilities according to the overall proportions) In determining chargeable liabilities, certain liabilities can be excluded (e.g. deposits and sovereign repo liabilities) and other specified liabilities netted against assets	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					(although not below zero) Equity capital is not taxed 01 January 2011 – 28 February 2011: 0,05% for short-term chargeable liabilities and 0,025% for long-term chargeable equity and liabilities 01 March 2011 – 30 April 2011: 0,1% for short-term chargeable liabilities and 0,05% for long-term chargeable equity and liabilities 01 May 2011 – 31 December 2011: 0,075% for short-term chargeable liabilities and 0,0375% for long-term chargeable equity	

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					and liabilities (Long-term liabilities are those with over one year remaining to maturity at the balance sheet date) Not deductible for corporation tax purposes	
	Gross Profits Tax **(Betting Duty)**	Tax levied on 'net stake receipts': profits made by business from its Financial Spread Betting services	The business providing the service pays this Tax Applies where the business is carried on in the UK, even if the business is established outside	A "General Betting Duty Spread Betting Return" has to be submitted quarterly to HMRC Standard accounting periods are calendar months but different	3% for financial spread bets	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
			the UK (even for corporation tax purposes)	periods can be agreed with the HMRC The completed return and payment must be submitted no later than 15 days following the end of the accounting period		
	Stamp Duty	Transfer of shares in companies, OEICS and unit trusts	Payable by the purchaser, on the purchase price Applies to UK assets Applies to non-UK assets where documents are created in the UK	Payable when the purchase is made The purchaser has to file a return Deadline for filing return and making payment is 30 calendar days	0,5% of the purchase price For shares in companies, the first £1,000 is not taxed, any amount over that is taxed No minimum for shares in OEICS or	N/A

Country	Tax	Transactions envisaged	Application	Formalities	Taxable base	Pending discussions for future implementation
					unit trusts	

ENCLOSURE 16: QUESTIONNAIRE ON LABOUR TAXATION IN THE FINANCIAL SECTOR

Labour Taxation in the Financial Sector
1. Salaries and bonuses Are salaries (including cash bonuses) paid to employees in the Financial Sector treated differently for income tax, social security tax purposes or for any other salary tax purposes than salaries paid in other sectors of activities? (*e.g. are salaries subject to specific wage withholding rates, are employee's and employer's social security contributions levied at rates specific to the financial sector, are salaries paid to employees in the financial sector benefiting from specific tax concessions (lower tax rate, …)*…) In the affirmative, please clarify under which conditions and to which extent salaries in the financial sector would be treated differently (e.g. more favourably) and clarify the rationale of this differentiated treatment
2. Stock Options Are stock options schemes in the Financial Sector benefiting from specific tax concessions (from an income tax, a social security tax perspective or from any other salary tax perspective) in comparison to those stock option schemes implemented in other sectors of activities? In the affirmative please clarify under which conditions and to which extent stock option schemes in the Financial Sector would be treated differently (e.g. more favourably) and clarify the rationale of this differentiated treatment

Labour Taxation in the Financial Sector
3. Other incentive pay schemes Amongst other incentive pay schemes (e.g., restricted stock units, stock appreciation rights, ….) is there any or more than one of these incentives in the Financial Sector benefiting from specific tax concessions (from an income tax, a social security tax perspective or from any other salary tax perspective) in comparison to those incentive schemes implemented in other sectors of activities? In the affirmative please clarify under which conditions and to which extent these other incentive schemes in the Financial Sector would be treated differently and clarify the rationale of this differentiated treatment
4. Dividend income and capital gain on shares Is dividend income on shares issued by a financial institution taxed differently for an individual shareholder than dividend income on shares issued by a company of another sector of activities? Does your answer differ if the shareholder is an employee of the company having issued the shares? Is capital gain on shares issued by a financial institution taxed differently for an individual shareholder than capital gain on shares issued by a company of another sector of activities? Does your answer differ if the shareholder is an employee of the company having issued the shares?
5. Differentiation For all the questions above would your answers be different according to whether the financial institution is a domestic one or a subsidiary or a branch of a non-domestic financial institution?

Labour Taxation in the Financial Sector
6. Practices For all the above conditions is there any information as whether actual practices may differ from legal provisions?
7. Miscellaneous Are you aware of any other information on the basis of which one might conclude that the individual tax treatment (including social security tax treatment or any other salary tax treatment) of salaries and incentives in the Financial Sector might be treated differently than in other sectors of activities?

ENCLOSURE 17: ADDITIONAL QUESTIONNAIRE ON THE LABOUR TAXATION IN THE FINANCIAL SECTOR

Additional Questionnaire on the Labour Taxation in the Financial Sector	
1. Could you please confirm that the answers that you provided in the first questionnaire remain valid irrespective of whether the pay (i.e. fix pay, bonuses, equity incentives,…) is allotted to board members or people who are not board members? If "No" please clarify shortly.	Yes - No
2. Could you please confirm that the corporate tax deductibility of costs of pay (for both board members and non board members) is the same in the Financial Sector as in other sector of activities? If "No" please clarify shortly.	Yes – No
For both board members and non board members, 3.1 Is there a favourable tax treatment applicable to stock options in your country? 3.2. In the affirmative, is this favourable tax treatment subject to conditions? 3.3. Is this favourable tax treatment applicable in the Financial Sector in the same way as it is in the other sectors?	 Yes - No N/A - Yes - No N/A - Yes - No
For both board members and non board members, 4.1 Is there a favourable tax treatment applicable to some other equity incentives in your country? 4.2. In the affirmative, is this favourable tax treatment subject to conditions? 4.3. Is this favourable tax treatment applicable in the Financial Sector in the same way as it is in the other sectors?	 Yes - No N/A - Yes - No N/A - Yes - No

Additional Questionnaire on the Labour Taxation in the Financial Sector	
5. If you answered affirmatively to questions 3.1 and 4.1. above, based on your experience, do you believe that pay structures in the Financial Sector might include stock options and/or some other equity incentives in a proportion structurally different than in other sectors so that indirectly pay packages in the Financial sector might be taxed differently (less or more) than in other sectors of activities. (Note: we appreciate that a scientific approach would require you to be aware of the possible different pay practices in the financial sector on the one hand and other sectors of activities on the other hand. At this stage we just need your thoughts based on your basic knowledge of the market practices).	Yes - No

ENCLOSURE 18: SECURITIES TRANSACTION TAXES

Country	Securities transaction taxes applicable in principle	On regulated markets	Type of securities in scope	Provision	Rate	Remarks
BELGIUM	Tax on Stock Exchange Transactions	Yes	All securities	Sections 120 *et seq.* of the Belgian Miscellaneous Duties and Taxes Code - "MDTC"	0.17% (or 0.5% or 0.07% depending on the type of security)	There is an exemption for non-residents and the Financial Sector acting for its own account
CYPRUS	Levy on transactions effected in respect of securities listed at the Cypriot Stock Exchange	Yes	'Titles', meaning shares, stocks, debentures, founding and other titles of companies that are listed at the Stock Exchange	Law 161 (I)/99	0.15%	This legislation ceases to be of effect from 31 December 2011
	Stamp Duty	No, exempt if listed at stock exchange	Securities issued by Cypriot-resident companies	Stamp Duty Law L19/1963	0.15% (on the first EUR 170,860) plus 0.2% (on amounts over 170,860)	Stamp duty is applicable to the agreement and not to the transaction
FINLAND	Transfer tax	No, exempt if traded on a qualifying market	Finnish securities, e.g. equities, PPL, stock options, but not debt securities or derivatives	Transfer Tax Act (29.11.1996/931)	1.6%	
FRANCE	Registration tax	No	French listed or non-listed stocks, bonds	Sections 680 and 726 of the French Tax Code.	3% (or 5% in relation to a shareholding in a real estate company), after a reduction of EUR 23,000	This tax cannot strictly speaking be considered a securities transaction tax, as it is a registration tax
GREECE	Transaction duty	Yes, but also OTC transfers of Greek listed shares are subject to the duty	Greek or foreign listed shares and compound products such as equity swaps, call options, futures	L.2703/1999	0.15%	Draft bill in which amendments are proposed, for example abolition of transaction duty for the sale of listed shares initially acquired after 1.1.2012

Country	Securities transaction taxes applicable in principle	On regulated markets	Type of securities in scope	Provision	Rate	Remarks
IRELAND	Stamp duty		Stocks or marketable securities (including derivatives) of an Irish company or Irish immovable property	Sections 2, 88 and 90 and Schedule 1 of the Stamp Duties Consolidation Act 1999	1% but possibly up to 6%	
ITALY	N/A	N/A	N/A	N/A	N/A	The Italian Securities Transfer Tax has been repealed for contracts signed on and after 31 December 2007
POLAND	Taxation of sale or exchange of property rights	No, exemption for transactions within an organised market	Securities and derivatives, except Polish treasury bonds etc.	Civil Law Activities Tax Law dated 9 September 2000	1%	
ROMANIA	Securities transaction taxes	Yes, whether on the regulated market or not	All types of securities	Regulation No. 7/2006 regarding revenues of the National Securities Commission ("NSC"); Emergency Ordinance No. 25/2002 for approval of the NSC Statute; Decision No. 1/2010 for approval of the NSC budget for 2010 (Annex 1)	A commission of a maximum of 0.08% or a monitoring fee of 0.15%; a commission of 0.10 RON when derivatives are involved	
UK	Stamp Duty and Stamp Duty Reserve Tax		Equities, certain equity derivatives (cash-settled derivatives excluded) and some loans having equity-like features	Finance Act 1986, Section 87	0.5% (or 1.5%)	Certain recognised intermediaries (Financial Sector traders) are given an exemption
SINGAPORE	Stamp duty	No, not applicable to transactions on the Singapore Exchange via the scripless settlement system	Stocks and shares, including debt with certain features		0.2%	
SWITZERLAND	Transfer stamp tax	Yes	Bonds, shares (including shares in investment funds)	Swiss Federal Stamp Duty Act (StG)	0.15% for domestic securities and 0.3% for foreign securities	Foreign banks and securities dealers are exempt parties, amongst others

ENCLOSURE 19: EQUITY SWAPS

Country	General / specific tax rules	Difference FS / non-FS (exc. timing)	Taxation payment received (exc. timing)	Deduction of payments made (exc. timing)	WHT on payment to non-residents (under the swap)	WHT on payment to non-residents (sale of the swap)	DTT classification	
							(under the swap)	(sale of the swap)
AUSTRIA	General	No	Yes	Yes	No	No	Other	Gain
BELGIUM	General	No	Yes	Yes	No	No	Other	Gain
BULGARIA	General	No	Yes	Yes	Yes	Yes	Profits	Gain
CYPRUS	General	No	No	No	No	No	N/A	N/A
CZECH REPUBLIC	General	No	Yes	Yes	No	Yes	Other	Gain
DENMARK	General	No	Yes	Yes	No	No	N/A	N/A
ESTONIA	General	No	Yes	Yes	No	No	Other	Gain
FINLAND	General	No	Yes	Yes	No	No		
FRANCE	General	Yes	Yes	Yes	No	No	Other	Other
GERMANY	General	Yes	Yes	Yes	No	No	Other	Gain / other
GREECE	Specific (listed derivatives) / General (others)	Yes / No	Yes / Yes	Yes / Yes (if hedging)	No	No	Profits	Profits
HUNGARY	General	No	Yes	Yes	No	No	N/A	N/A

Country	General / specific tax rules	Difference FS / non-FS (exc. timing)	Taxation payment received (exc. timing)	Deduction of payments made (exc. timing)	WHT on payment to non-residents (under the swap)	WHT on payment to non-residents (sale of the swap)	DTT classification	
							(under the swap)	(sale of the swap)
IRELAND	General	Yes	Yes	Yes	No	No		
ITALY	Specific	No	Yes	Yes	No	No		
LATVIA	General	No	Yes	Yes	No	No		
LITHUANIA	Specific (unrealised items)	No	Yes	Yes	No	No	N/A	N/A
LUXEMBOURG	General	No	Yes (No: if substance over form)	Yes (No: if substance over form)	No	No		
MALTA	General	No	Yes	Yes	Unclear	Unclear	Unclear	Unclear
NETHERLANDS	General	No	Yes	Yes	No	No	Other	Other
POLAND	General	No	Yes	Yes	No	No		
PORTUGAL	Specific	No	Yes	Yes	No	No		
ROMANIA	General	Yes	Yes	Yes	No	No	Other / Profits	Other / Profits
SLOVAKIA	Specific	Yes	Yes	Yes (FS only)	Yes	Yes	Other	Gain
SLOVENIA	General	No	Yes (No: PER)	Yes (No: PER)	Yes	No	Other (div.)	Gain
SPAIN	General	No	Yes	Yes				
SWEDEN	General	Yes	Yes	Yes	No	No	N/A	N/A

Country	General / specific tax rules	Difference FS / non-FS (exc. timing)	Taxation payment received (exc. timing)	Deduction of payments made (exc. timing)	WHT on payment to non-residents (under the swap)	WHT on payment to non-residents (sale of the swap)	DTT classification	
							(under the swap)	(sale of the swap)
UK	Specific	Yes	Yes	Yes	No	No	Other	Other
CHINA	General	No	Yes	Yes	Yes		Profit	
SINGAPORE	General	Yes	Yes	Yes	No (in principle)			
SWITZERLAND	General	No	Yes	Yes	No	No	Gain	Gain
USA	Specific	Yes	Yes	Yes	No	N/A	Other	Other

ENCLOSURE 20: FINANCIAL FUTURES

Country	General / specific tax rules	Difference FS / non-FS (exc. timing)	Tax treatment of gains / losses (exc. timing)		Mark-to-market	Payment to non-residents		DTT classification		
						Expiration	Sale			
			Taxable / Deductible	When / How		WHT	WHT	Expiration	Sale	Nature underlying
AUSTRIA	General	No	Yes	Upon accrual	No, but permitted for FS	No	No	Other	Gain	Yes, if closed items
BELGIUM	General	No	Yes	P/L	No, but in general applied by FS	In principle, no	In principle, no	Other	Gain	Possibly
BULGARIA	General	No	Yes	Receipt (10% CTX)	Yes	Yes	Yes	Profits	Gain	
CYPRUS	General	No	No	10% CTX	No	No	No	N/A	N/A	
CZECH REPUBLIC	General	No	Yes	Changes in fair value	Yes	Yes	Yes	Other	Gain	
DENMARK	General	No	Yes	Unrealised basis	Yes	No	No	N/A	N/A	
ESTONIA	General	No	Yes (losses are not deductible)	Upon distribution (21% CTX)	No	No	No	Gain	Gain	
FINLAND	General	No	Yes	Realisation principle (26% CTX)	No	No	No			
FRANCE	General	Yes	Yes	Accrual (33.33% CTX)	N o	No	No	Other	Other	
GERMANY	General	Yes	Yes		Yes	No	No	Other	Gain/ other	

Country	General / specific tax rules	Difference FS / non-FS (exc. timing)	Tax treatment of gains / losses (exc. timing)		Mark-to-market	Payment to non-residents		DTT classification		
						Expiration	Sale			
			Taxable / Deductible	When / How		WHT	WHT	Expiration	Sale	Nature underlying
GREECE	Specific (listed derivatives) / General (others)	Yes / No	Yes / Yes		Yes	No	No	Profits	Profits	
HUNGARY	General	No	Yes	When accounted	Optional	No	No	N/A	N/A	
IRELAND	General	Yes	Yes	Based on accounting	Generally yes	No	No			As per the underlying asset
ITALY	General	No	Yes		No	No	No			
LATVIA	General	No	Yes	When realised (15% CTX)	No	No	No	N/A	N/A	
LITHUANIA	Specific (unrealised items)	No	Yes		No	No	No	N/A	N/A	
LUXEMBOURG	General	No	Yes (No: if substance over form)	28.80 % CTX	No	No	No			Possibly
MALTA	General	No	Yes	35% CTX	Yes	Unclear	Unclear	Unclear	Unclear	
NETHERLANDS	General	No	Yes		No, but allowed	No	No	Other	Other	
POLAND	General	No	Yes		No	No	No			
PORTUGAL	Specific	No	Yes		Yes	No	No			No
ROMANIA	General	Yes	Yes		No	No	No	Other/profits	Other/profits	

Country	General / specific tax rules	Difference FS / non-FS (exc. timing)	Tax treatment of gains / losses (exc. timing)		Mark-to-market	Payment to non-residents		DTT classification		
						Expiration	Sale			
			Taxable / Deductible	When / How		WHT	WHT	Expiration	Sale	Nature underlying
SLOVAKIA	Specific	Yes	Yes taxable; yes deductible for FS only		Yes	Yes	Yes	Other	Gain	No
SLOVENIA	General	No	Yes		Yes	No	No	Other	Gain	
SPAIN	General	No	Yes	30% CTX	No	No	No			No
SWEDEN	General	Yes	Yes	Accrued (FS) / Receipt (non-FS)	Yes for FS	No	No	N/A	N/A	
UK	Specific	Yes	Yes	Usually accounts basis	No	No	No	Other	Other	
CHINA	Not permitted									
SINGAPORE	General	Yes	Yes		Yes	No, in principle				
SWITZERLAND	General	No	Yes	P/L	No	No	No	Gain	Gain	No
USA	Specific	No	Yes		Yes	No	N/A		Gain	

ENCLOSURE 21: CALL OPTIONS ON STOCK

Country	Generalities		Holder												Write			
	General / specific tax rules	Difference FS / non-FS (exc. timing)	Premium				Taxation/ deduction of gains/ losses				Mark-to-market	WHT (premium to non-residents)	DTT classification (premium)	Packaged product	Premium			
			Deductible	When / How	Difference FS / non-FS	Stock acquisition price	Disposal	Exercise	Sale (shares)	Expiration					Taxable	When / How	Difference FS / non-FS	d
AUSTRIA	General	No	Yes	Expiration	No	Yes	Yes	No	Yes (No: PER)	Yes	Permitted (FS)	No	N/A	One product	Yes	Exercise / Expiration	No	Ye
BELGIUM	General	No	Yes	Expiration	No	Yes	Yes	No	Yes (No; PER)	Yes	Yes (FS)	No	N/A	One product	Yes	P/L	No	No
BULGARIA	General	Yes	Yes	Expiration / exercise	Yes	Yes	Yes	No	Yes	Yes	Yes (FS)	Yes	Profits	General rules	Yes	Expiration	Yes	Ye
CYPRUS	General	No	No	N/A	No	Yes	No	No	No	No	No	No	N/A	General rules	No	N/A	No	Ye
CZECH REPUBLIC	General	No	Yes	P/L	No	Sometimes	Yes (P/L)	Yes (P/L)	Yes	Yes (P/L)	Yes	Yes	Other	Option	Yes	P/L	No	So
DENMARK	General	No	Yes	P/L	No	Yes	Yes (P/L)	Yes (P/L)	Yes (P/L; No if PER)	Yes (P/L)	Yes	No	N/A	N/A	Yes	Issuing	No	No
ESTONIA	General	No	Yes	Expiration	No	Yes	Yes (N/A)	Yes (N/A)	Yes (N/A)	Yes (N/A)	Yes	No	Other	General rules	Yes	Distribution	No	Ye

Country	Generalities		Holder												Write			
	General / specific tax rules	Difference FS / non-FS (exc. timing)	Premium				Taxation/ deduction of gains/ losses				Mark-to-market	WHT (premium to non-residents)	DTT classification (premium)	Packaged product	Premium			
			Deductible	When / How	Difference FS / non-FS	Stock acquisition price	Disposal	Exercise	Sale (shares)	Expiration					Taxable	When / How	Difference FS / non-FS	d
FINLAND	General	No	Yes	Exercise / expiration / closing out / P/L	No	Yes	Yes	Yes (Cash) / No (Delivery)	Yes	Yes	Sometimes	No	Unclear	One product	Yes	Exercise / expiration / closing out / Receipt / P/L	No	No
FRANCE	Specific	Yes	Yes	Exercise	Yes	Yes (non-listed) / No (listed)	Yes	No (non-listed) / Yes (listed)	Yes (No: PER)	Yes	Yes (listed)	No	Other	Option	Yes	Exercise / P/L	Yes	Ye lis
GERMANY	General	No	Yes	Exercise / offsetting	No	Yes	Yes	Yes (Cash) / No (Delivery)	Yes	No	Yes	No	Gain	Option	Yes	Issuing	Yes	No
GREECE	Specific (listed derivatives) / General (others)	Yes / No	Yes		Yes	No	Yes (N/A)	Yes (N/A)	Yes (N/A)	Yes (N/A)	No	No	Profits		Yes		Yes / No	
HUNGARY	General	No	Yes	P/L	Yes	Sometimes	Yes	No	Yes (No: PER)	N/A	Option	No	N/A	Case by case	Yes	P/L	Yes	No
IRELAND	General	Yes	Yes	P/L	Yes	No (FS) / Yes (other)	Yes	No	Yes	No	If in the accounts (FS)	No	Underlying		Yes	P/L	Yes	So

Country	Generalities		Holder												Write			
	General / specific tax rules	Difference FS / non-FS (exc. timing)	Premium				Taxation/ deduction of gains/ losses				Mark-to-market	WHT (premium to non-residents)	DTT classification (premium)	Packaged product	Premium			
			Deductible	When / How	Difference FS / non-FS	Stock acquisition price	Disposal	Exercise	Sale (shares)	Expiration					Taxable	When / How	Difference FS / non-FS	d
ITALY	Specific	No	Yes	P/L	No	Yes	Yes	No	Yes (No: PER)	Yes	Sometimes	No			Yes	P/L	Yes	
LATVIA	General	No	Yes	P/L	No	Sometimes	Yes	Yes	Yes (No: EEA listed shares)	Yes	No	No	N/A		Yes	P/L	No	So
LITHUANIA	Specific (unrealised items)	No	Yes	Acquisition	No	Sometimes	Yes	No	Yes (No: PER)	Yes	No	No	N/A	Two products	Yes	Accrual	No	No
LUXEMBOURG	General	No	Yes	Expiration	No	Yes	Yes	No	Yes (No: PER)	Yes	No	No		One product	Yes	Expiration	No	Ye
MALTA	General	No	Yes		No	Unclear	Unclear	Unclear	Unclear	Unclear	Yes	Unclear	Unclear	Unclear	Yes	Unclear	No	Ur
NETHERLANDS	General	No	Yes (No: PER)			Yes (if PER) / unclear (other)	Yes	Yes	Yes (No: PER)	Yes	Option	No	Other	General rules	Yes	Exercise / expiration	No	No
POLAND	General	No	Yes	Exercise / expiration	No	No	Yes	Yes	Yes	Yes	No	No		Two products	Yes	P/L	No	No
PORTUGAL	General	No	Yes	P/L	No	No	Yes	Yes	Yes	Yes	Yes	No	Profits / other	P/L	Yes		No	No

Country	Generalities		Holder												Write			
	General / specific tax rules	Difference FS / non-FS (exc. timing)	Premium				Taxation/ deduction of gains/ losses				Mark-to-market	WHT (premium to non-residents)	DTT classification (premium)	Packaged product	Premium			
			Deductible	When / How	Difference FS / non-FS	Stock acquisition price	Disposal	Exercise	Sale (shares)	Expiration					Taxable	When / How	Difference FS / non-FS	d
ROMANIA	General	Yes	Yes	Acquisition	No	No	Yes	Yes	Yes	Yes	No	No	Other / profits	Two products	Yes	P/L	No	Ur
SLOVAKIA	Specific	Yes	No		No	Yes	Specific (FS / other)	No	Specific (FS / other)	Yes	Yes	Yes	Other	General rule	Yes	Exercise / Expiration	No	No
SLOVENIA	General	No	Yes	Expiration	No	Yes	Yes	No	Yes (No: PER)	Yes	Unclear	No	Gains / other	Unclear	Yes	P/L	No	Ur
SPAIN	General	No	Yes	P/L	No	Unclear (P/L)	Yes (P/L)	Yes (P/L)	Yes (P/L)	Yes (P/L)	Yes			Case by case	Yes (P/L)	P/L	No	Ur
SWEDEN	General	Yes	Yes	Expiration	Yes	Yes	Yes	No	Yes	Yes	Yes (FS)	No	Other income	One product	Yes	P/L	Yes	Ye
UK	Specific	Yes	Yes	Yes	Yes	Yes (non-FS)	Yes	Yes(FS) / No (non-FS)	Yes	Yes	Sometimes	No	Other	P/L	Yes	P/L	Yes	No sor (no
CHINA	N/A		N/A												N/A			
SINGAPORE	General	Yes	Yes	P/L	Yes	P/L	Yes (P/L)	Yes (P/L)	Yes (P/L)	Yes (P/L)	Sometimes	No (in principle)	Profits / interest		Yes	P/L	Yes	P/I
SWITZERLAND	General	No	Yes	P/L	No	Yes	Yes	No	Yes (NO: PER)	Yes	No	No	Gain	Case by case	Yes	P/L	No	Ye

Country	Generalities		Holder												Write			
	General / specific tax rules	Difference FS / non-FS (exc. timing)	Premium				Taxation/ deduction of gains/ losses				Mark-to-market	WHT (premium to non-residents)	DTT classification (premium)	Packaged product	Premium			
			Deductible	When / How	Difference FS / non-FS	Stock acquisition price	Disposal	Exercise	Sale (shares)	Expiration					Taxable	When / How	Difference FS / non-FS	d
USA	Specific	Yes	Yes		Yes	Yes (delivery) / No (cash)	Yes	No (delivery) / Yes (cash)	Yes	Yes	Sometimes	No	N/A	Case by case	Yes		Yes	Ye (de / N

ENCLOSURE 22: QUESTIONNAIRE ON TAXATION OF FINANCIAL INSTRUMENTS

The purpose of this part of the study is to examine the tax treatment of different financial instruments, either when taxed indirectly via securities taxes or when accounted for in the calculation of other taxes, notably the corporate income tax. Please provide a high level answer to the following questions based on law as applicable on financial year 2011 (January 2011).

For certain questions, we provided the involved countries with a clarification and/or an illustrative example in order to have additional insights about the answers given to these questions. The clarifications and examples provided are the following:

B. Corporate income tax treatment of equity Swaps

Clarification as regards an equity swaps:

Definition: an equity swap is a financial derivative contract (a swap) where a set of future cash flows are agreed to be exchanged between two counterparties at set dates in the future. The two cash flows are usually referred to as "legs" of the swap; one of these "legs" is usually pegged to a floating rate such as LIBOR. The other leg of the swap is based on the performance of either a share or a stock market index. This leg is commonly referred to as the "equity leg". Most equity swaps involve an interest leg v. an equity leg, although some exist with two equity legs.

Example: Equity swap arrangement between A and B. Both companies have an accounting year and a tax year closing at calendar year-end (31 December). A is paying every quarter to B dividends and capital gains from the underlying stocks where B is paying A an interest rate and capital losses on the same underlying stocks. Let's assume that the swap arrangement has been signed end of November, and first payment has to be made end of January.

- The market value of the swap based on future payments is 200 end of December in favour of B.
- One month later, a payment of 300 has to be made by A to B.

From an economic point of view, this payment can be broken down into 100 from B to A (interest leg) and 400 from A to B (equity leg, including 30 of dividends received and 370 of capital gains).

This amount of 300 is thus the netted amount and constitutes a payment under the swap arrangement and includes economically a "dividend component" (30 in this example).

E. Corporate income tax treatment of Call options on stocks in the hands of the holders

Example:

- The holder has paid 10 to acquire a call on shares with a strike price of 100.
- At maturity, the market value of the shares is 130.
- The call is exercised by the holder and the latter will pay the strike price of 100 to the issuer.

F. Corporate income tax treatment of Call options on stocks in the hands of the writers

3. Example:

- The issuer has acquired shares for 80, issued a call on these shares for a strike price of 100 and received a premium of 10.
- At maturity, the market value of the shares is 130.
- The call is exercised by the investor and the latter will pay the strike price of 100 to the issuer.
- The issuer has received cash-wise 110 (10 premium and 100 strike price).

- What is the result in this case from a tax perspective? Is it a gain on shares of 20 and a premium of 10, or a gain on shares of 30 since the premium received is part of the share delivery price? We assume that it can make a difference since premiums are often considered as taxable whereas gains on shares may, under certain conditions, be tax exempted.

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J. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 8. Are there securities transactions taxes on transfers of financial instruments? 9. What securities are in scope and which are exempt? 10. What are the tax provisions (reference to applicable tax section)? 11. Tax base? 12. Tax rate? Is there a maximum amount of tax due? 13. Tax event? 14. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 15. Who is liable for levying the tax? Who is liable to support the tax?	In Austria there are no taxes on the transfer of financial instruments.
K. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	1. In Austria there are no specific rules applicable to swap transactions. The general tax regime applies. 2. Generally there is no difference if one or both of the counterparties are companies in the non Financial Sector. 3. The CIT follows the accounting rules. There are no specific accounting rules for swaps. The general rules are applicable. In General, flows of payment are taxable on an accrual basis for corporations, but each transaction has to be evaluated

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16. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 17. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 18. Are the flows of payments received taxed, if yes, when and how? 19. Are the flows of payments made tax deductible, if yes, when and how? 20. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 21. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 22. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	individually. From an accounting point of view, if the equity swap is held as fixed assets the lower of cost or market valuation has to be used. If the equity swap is held in the trading book or not held as fixed assets the mark to market valuation has to be used. As for hedge accounting similar rules to IAS 39 are applicable. 4. The exchange of dividend payments could be tax neutral: If dividends are transferred as a part of an equity swap equity, those dividends could be tax free because they are treated as if they would be distributed to the beneficial owner directly. E.g. Dividends distributed from an Austria corporation to another Austria corporation are tax exempt. The CIT follows the accounting rules; in General, flows of payment are tax deductible, but each transaction has to be evaluated individually. Flows of payments are deductible on an accrual basis for corporations. From an accounting point of view, we refer to 3. 5. Generally in Austria there is no WHT for non residents with the exception of dividends in some cases. In other words, there should not be WHT on the payments made under an equity swap agreement excluding manufactured dividends under the involvement of Austrian banks. 6. No 7. In most Double tax treaties the payments are (if taxable) qualified as “other income“ or as “Capital gains”. E. g. in case the hedging transaction is regarded as closed items with the corresponding underlying transaction, the payments could be qualified the same (for e.g. dividend) as the underlying. Manufactured dividends and interests are qualified as dividends and interests. WHT could only be made on manufactured dividends in the case an Austrian bank is involved (the bank is the party who gets the shares). Other payments are qualified as other income or capital gains.

AUSTRIA	
L. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. In Austria there are no specific rules applicable to Financial Futures. The general tax regime applies. 2. Generally there is no difference if one or both of the counterparties are companies in the non Financial Sector. 3. Gains and losses are taxed / deductible, either when payment accrues or when the transaction is entered in the accounting (CIT follows the accounting rules). Hence there are no specific rules; each transaction has to be evaluated individually. 4. For non financial companies mark-to-market is not applied. For financial institutions mark-to-market valuation is permitted. For conditions under which this method applies we refer to B.3 above. 5. Generally in Austria there is no WHT for non-residents. 6. Generally in Austria there is no WHT for non-residents. 7. In most Double tax treaties the payments are (if taxable) qualified as “other income“ or as “capital gains”. E. g. in case the hedging transaction is regarded as closed items with the corresponding underlying transaction, the payments could be qualified the same (for e.g. Interest) as the underlying.

AUSTRIA	
M. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	General overview about the accounting of premiums: I. From the writer's perspective: a. At the time of receipt the premium is shown as liability. b. At the time of exercise and expiration the premium is shown as income (and taxable). II. From the holder's perspective: a. At the time of payment the premium is shown as other accounts receivable. b. At the time of exercise the premium becomes part of acquisition costs. c. At the time of expiration the premium becomes other expense (and taxable). 1. In Austria there are no specific rules applicable to Call Options. The general tax regime applies. 2. In general there is no difference if one or both of the counterparties are companies in the non Financial Sector.
N. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any	General overview about the accounting of premiums: From the holder's perspective: a. At the time of payment the premium is shown as other accounts

AUSTRIA	
specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (iv) exercise of the options, (v) sale of the shares acquired through the option, (vi) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	receivable. b. At the time of exercise the premium becomes part of acquisition costs. c. At the time of expiration the premium becomes other expense (and taxable). 1. At the expiration date of the call, the premium is deductible. This is the only scenario where the premium is a deductible item for the investor. 2. Generally there is no difference if the holder is a bank/insurance company or a company active in the non Financial Sector. 3. Yes, the premium paid is part of the future acquisition price. 4. (i) Gains or losses realised at the disposal of the option are tax effective. By "effective", we mean "taxable" for the gains / "deductible" for the losses. (ii) The premium paid is part of the acquisition costs at the exercise of the option. (iii) in general the sale of the shares acquired through the option is tax effective. In the case the share are from a foreign corporation and held by an Austrian corporation and the stake in the company is ≥ 10% and the Holding Period is ≥ 1 year, the sale of shares acquired through the option is NOT tax effective. (iv) The premium paid is classified as expenses at the time of expiration. 5. For non financial companies mark-to-market is not applied. For financial institutions mark-to-market valuation is permitted. For conditions under which this method applies we refer to B.3 above. 6. There is no WHT on premium to non-residents.

AUSTRIA	
	7. In Austria premium payments to non-residents are not subject to (withholding) tax. 8. Options are generally not separated if they are part of a packages product; i.e. is seen as one product.
O. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	General overview about the accounting of premiums: From the writer's perspective: a. At the time of receipt the premium is shown as liability. b. At the time of exercise and expiration the premium is shown as income (and taxable). 1. For writers, the premium received is not taxable in the time of receipt. It is taxable in the time of exercise and expiration of the option. 2. Generally there is no difference if the writer is a bank/insurance company or a company active in the non Financial Sector. 3. Yes. Based on the example, in our opinion the premium is part of the delivery price and in the time of exercise generally taxable. In most cases it makes no difference except the "International tax exemption" is applicable. In this case capital gains are tax exempt. 4. Yes 5. For non financial companies mark-to-market is not applied. For financial institutions mark-to-market valuation is permitted.

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P. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	Generally there will not be any difference, except certain security transactions where the bank has to withhold tax on dividend payments to other countries.
Q. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No.

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A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. There is securities tax (referred to as “tax on stock exchange transactions” or “stamp duties”) which applies to certain transactions concluded or executed in Belgium through a Belgian professional intermediary to the extent that they relate to public funds, irrespective of their (Belgian or foreign) origin. The transactions in scope are: - every sale, purchase and, in general, every transaction for valuable consideration (secondary market transactions) Note that on a given secondary market transaction, the tax is due twice: in the hands of the seller (sale) and in the hands of the buyer (purchase) provided that the transaction is carried out between Belgian parties; - every redemption of its own shares by an investment company provided that the redemption relates to "accumulating shares". 2. All types of financial instruments are in scope, for instance equity, shares of investment companies, bonds, and some derivative instruments. However, the transaction must relate to public funds. The notion "public funds" refers to all marketable securities, which, by their nature, are susceptible of being traded on an organized exchange. Please note that the tax is not due upon subscription of new securities (primary market transactions). Previously, primary market transactions were in some cases in scope but the concerned provision was cancelled as a consequence of the decision of European Court of Justice dated 15 July 2004 (case C-415/02). The tax is not due if no Belgian intermediary acting in the course of its business intervenes in the deal (being the acquisition or sale of the securities). The notion “Intermediary” covers any person whose professional activity consists of carrying out

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	stock exchange transactions. 3. Article 120 and further of the Belgian Code of Various Duties and Taxes "CVDT" (Wetboek diverse rechten en taksen / Code des droits et taxes divers). 4. The tax is due: - for acquisitions or purchases, on the sums to be paid by the purchaser after deduction of the brokerage commission. - for sales, on the sums to be received by the seller or assignor, without deducting the brokerage commission. - for redemptions of own accumulating shares by a SICAV, on the Net Asset Value (hereafter "NAV"), without any deduction of lump sum charges. - for redemptions of own accumulating shares being "in scope" for article 19*bis* of the Belgian Income Tax Code (i.e. SICAVS with EU passport investing for more than 40% in receivables / debts securities for which a WHT is due upon liquidation / redemption of own shares) on the NAV, without any deduction of lump sum charges, but reduced by the WHT withheld. 5. The rate of the tax on stock exchanges transactions varies in accordance with the type of transactions: The rate amounts to: - 0,07 % (subject to a maximum of EUR 500 per transaction) for distributing shares of investment companies, certificates of contractual investment funds (i.e. without legal personality), bonds of the Belgian public debt or the public debt of foreign states, nominative or bearer bonds, certificates of bonds, etc. - 0,5 % (subject to a maximum of EUR 750 per transaction) for accumulating shares of investment companies, such as SICAVs - 0,17 % (subject to a maximum of EUR 500 per transaction) for any other securities

	(such as shares). There are also some specific exemptions from the tax, amongst which the most important ones in practice: - transactions made for its own account by some financial institutions, such as banks, insurance companies, organizations for financing pensions (OFPs), undertakings for collective investment, etc.; - transactions made for its own account by non-resident taxpayers. 6. The taxable event is the execution of the transaction itself (cf. above). The tax normally has to be paid by the liable intermediary at the latest on the last working day of the month following the month during which the transaction was executed. 7. The connecting factor is the fact that the transaction in scope is concluded or executed in Belgium through a Belgian professional intermediary. 8. The Belgian professional intermediary is liable to pay the tax to the competent Belgian tax authorities. The tax is supported by the person/entity who concludes or executes the transaction (the buyer and/or the seller).
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	1. In Belgium general tax principles apply. There are no specific tax rules applicable on swap transactions. As a general rule, the tax treatment of an instrument follows its accounting treatment (Belgian GAAP), unless the applicable tax rules explicitly depart from the accounting rules. In general, it can be said that what is booked in the P&L as a cost will in principle be tax deductible, what is booked as a profit will generally be taxable. In absence of any specific rules with respect to the accounting treatment of equity swaps, this type of instruments should be booked based on general accounting principles. Recently, the Belgian Commission for Accounting Standards has published

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1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	an advice in which it determines the hierarchical order of principles to be applied. Note that banks, insurance companies, investment companies and OFP's each have their own accounting framework which differ from the accounting framework applicable to commercial companies. 2. From a Belgian tax perspective, there is no difference if counterparties are companies in the non-Financial Sector. The accounting framework being different (or more specific) for certain Financial Sector companies than for non Financial Sector companies, this could result in a different treatment. 3. The flows of payments received are taxed. They are part of the corporate income tax base of the company in the financial year in which they are booked in the P&L following the applicable accounting rules (Belgian GAAP). The corporate income tax rate in Belgium is 33,99%. 4. The flows of payments made are in principle tax deductible (provided that these expenses are made in order to acquire or conserve taxable income). As for the accounting result, they are therefore not included in the corporate income tax base of the company in the financial year they are booked as a cost in the P&L. 5. Belgian WHT can, as a rule, only be levied on income that is qualified as movable income in Belgian tax law (i.e. essentially interest and dividend income). As no income tax classification of equity swaps (or of the income arising from equity swaps) is available in Belgian income tax law, it can be argued that equity swaps are to be treated as having a *"sui generis"* character as a result of which the income derived from such contracts cannot be considered to fall under the provisions governing movable income. The argument for claiming such *"sui generis"* character is generally to be found in the definition of movable income, i.e. all proceeds of movable property that can be considered to be "engaged". It has been argued in doctrine that a qualification as movable income requires a (deliberate) deposit or engagement of capital, meaning (i) an underlying financing relationship or transfer of proceeds to be engaged by the recipient of the proceeds and (ii) the income which is derived from the movable goods to be

	considered a remuneration paid by the recipient of such means for the benefit of being able to use the given capital for his activities. Applied to derivative financial instruments, the given notion of "engagement" is in most cases considered not to be fulfilled. However, this should be analysed on a case-by-case basis. If it appears that the payments should be considered as interest from a Belgian income tax point of view, Belgian WHT will in principle be due. The standard Belgian WHT rate on interest is 15%. In such case, the question is whether Belgian domestic WHT exemptions/limitations could apply. Two types of exemptions could in principle apply in relation to non-residents, provided that certain conditions are fulfilled. The first exemption concerns interest payments from credit institutions established in Belgium to credit institutions established abroad (i.e. not in Belgium). The second type of exemptions concerns interest payments from credit institutions established in Belgium to non-resident beneficiaries. 6. Income from a sale of a swap is not considered as movable income, so no Belgian WHT can be due. 7. There exist no clear rules regarding the classification of payments (under the swap or upon the sale of the swap) under the double tax treaties. This depends on the swap agreement and the treaty in question and it may also depend on the nature of the underlying. In other words, this should be analysed on a case-by-case basis. In most cases the payments under the swap will be classified as other income and the payments upon a sale of the swap will be classified as capital gains.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would	1. In Belgium general tax principles apply. There are no specific rules applicable on financial futures transactions (cf. our comments under B.1. above). 2. From a Belgian tax perspective, there is no difference if counterparties are companies in

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have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	the non-Financial Sector. The accounting framework being different (or more specific) for certain Financial Sector companies than for non Financial Sector companies, this could result in a different treatment. 3. The flows of payments received are taxed and the flows of payments made are in principle tax deductible. They are part of the corporate income tax base of the company in the financial year in which they are booked in the P&L following the applicable accounting rules (Belgian GAAP). The corporate income tax rate in Belgium is 33,99%. 4. Mark-to-market is generally not applied for normal (non-FS) companies, but it can be applicable for financial institutions. 5. In most cases no Belgian WHT would be due. However, this should be analysed on a case-by-case basis (cf. our comments under B.5. above). 6. No WHT. 7. There exist no clear rules regarding the classification of payments (under the futures or upon the sale of the future) under the double tax treaties. This depends on the futures agreement and the treaty in question and it may also depend on the nature of the underlying. In other words, this should be analysed on a case-by-case basis. In most cases the payments under the futures will be classified as “other income” and the payments upon a sale of the futures will be classified as “capital gains”.

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D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. In Belgium general tax principles apply (there is an administrative tax circular dated 27 September 1993 which deals a.o. with options on stocks). There are no specific tax rules applicable on call stock options. As a general rule, the tax treatment of an instrument follows its accounting treatment (Belgian GAAP; for options there exist two advices of the Belgian Commission for Accounting Standards n° 167/1 and n° 167/2), unless the applicable tax rules explicitly depart from the accounting rules. In general, it can be said that what is booked in the P&L as a cost will in principle be tax deductible, what is booked as a profit will generally be taxable. Recently, the Belgian Commission for Accounting Standards has published an advice n° 2010/12 in which it determines the hierarchical order of principles to be applied. In Belgian accounting law, sometimes different rules are applicable depending on the hedging or speculative nature of the option. In addition, banks, insurance companies, investment companies and OFP's each have their own accounting framework which differ from the account framework applicable to "normal" companies. While the standard accounting rules apply in principle the "historical cost" approach, credit institutions apply more often a mark-to-market approach. 2. From a Belgian tax perspective, there is no difference if counterparties are companies in the non-Financial Sector. The accounting framework being different (or more specific) for certain Financial Sector companies than for non Financial Sector companies, this could result in a different treatment.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have	1. Whether or not the premium paid is tax deductible depends on whether from an accounting perspective the option is "activated" (i.e. recorded as an asset on the balance sheet of the holder). The preferred accounting treatment of the Belgian Commission for Accounting Standards is to record the premium as an asset on the assets side of the balance sheet at the acquisition value plus ancillary costs (the ancillary costs could also be booked as a

BELGIUM	
equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (vii) exercise of the options, (viii) sale of the shares acquired through the option, (ix) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	cost in the P&L which is tax deductible). The option cannot be amortised. In this case the premium will not be included as a cost in the P&L at the moment the option is acquired and will therefore not be tax deductible 2. From a Belgian tax perspective, there is no difference if the holder is a bank/insurance company or a company active in the non Financial Sector. However, since banks and insurance companies are subject to special accounting rules in relation to options, different accounting rules could be applicable, which results in a different tax treatment. 3. Yes. 4. (i) disposal of the options: realised capital gains are taxable, and realised capital losses are in principle tax deductible; (ii) exercise of the options: the premium paid is part of the stock acquisition price; (iii) sale of the shares acquired through the option: realised capital gains on shares are in principle tax exempted, provided that the subject to tax conditions are complied with. Realised capital losses on shares are not tax deductible; (iv) expiration of the option: in case of expiration of the (activated) option, a loss is recorded. This cost is in principle tax deductible. 5. Usually not. However, if the market price is lower than the acquisition price an impairment (Lower of Cost or Market) will be accounted. This is different for options acquired by a credit institution for trading purposes, which are subject to a mark-to-market treatment. 6. In principle, no WHT is due on premiums to non-residents. Cf. our comments under B.5 and B.6 above 7. Cf. our comments under B.7 above.

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	8. This should be analysed on a case-by-case basis, taking into account the agreement. In general, the tax treatment of the packaged product will follow the accounting treatment, unless the tax treatment derogates from accounting treatment (which is the case for realised capital gains or losses on shares).
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. The premium received is taxable. a. If the premium received is directly recorded as a profit in the P&L, it will be taxable in the corporate income tax return that relates to the financial year in which the profit is booked at the standard rate of 33,99%. On the other hand, in order to cover the risk, the writer will need to record a provision on the liabilities side of the balance sheet, which should be periodically revalued. This provision may or may not be tax deductible depending on the circumstances (amongst others physical delivery or cash settlement). b. The premium can also be recorded as deferred income, until expiry or exercise of the option. As a result, there will be no immediate taxable income for the writer. Any risk in excess of the amount of the premium must be reflected on the balance sheet by recording a provision on the liabilities side. Such provision is recorded in the P&L. The provision should be revalued at financial year-end. This provision may or may not be tax deductible depending on the circumstances (amongst others physical delivery or cash settlement). 2. From a Belgian tax perspective, there is no difference if the writer is a bank/insurance company or a company active in the non Financial Sector. However, since banks and insurance companies are subject to special accounting rules in relation to options, different accounting rules could be applicable in certain situations, which would result in a different tax treatment. 3. In principle, from a tax perspective, the premium received is not part of the stock

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	delivery price. 4. In case the premium was recorded as deferred income, upon exercise the premium will be recorded as income in the P&L and will be taxable at the standard rate of 33,99%. The provision, if any, previously recorded to cover the risk in excess of the premium, is reversed and taxable. The settlement amount payable is deducted from the P&L and could possibly constitute a tax deductible expense in case of cash settlement provided that the settlement amount is (i) an expense made for the purpose of acquiring or preserving taxable income, (ii) deducted during the year when it is paid or incurred, and (iii) at arm's length. In case of physical delivery of the shares, the loss realised, if any, will not be tax deductible. 5. It depends. In the Financial Sector the mark-to-market is applied in some cases (e.g. a credit institution with options on stock not destined for coverage). For other companies, according to the Belgian Commission for Accounting Standards, there is a choice between two methods. In a nutshell, either the company books a profit in the P/L and, at year-end, a provision (this results to a mark-to-market approach), or the company books the premium received directly on its balance sheet as a liability and a P/L entry only if the value of the option increases.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	To our knowledge, our answers would not be different according to whether the (financial) institution is a domestic one, or a subsidiary or a branch of a non-domestic (financial) institution. In case of a branch, attention should be paid that the correct double tax treaty is applied and of course, provisions of double tax treaties can differ.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	It should be mentioned that the tax treatment of derivative instruments is much dependent of the accounting treatment, for which some differing

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	practices may exist. Anti-abuse provisions may apply in case derivative instruments are used for tax reasons only. Some case-law exists in this respect concerning call options on stock.

BULGARIA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	No transfer taxes on disposal of securities – just notary fee in case of transfer of shares in a limited liability company.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain	[General principles of corporate income taxation to be kept in mind in the rest of the questionnaire: ▪ Gains / losses from disposal of securities are subject to standard tax treatment in case of local corporate sellers – taxable / deductible at 10% corporate income tax. ▪ Gains from sale of local securities are subject to 10% WHT in case of foreign resident sellers, unless the seller can invoke treaty

BULGARIA	
period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	protection. Seller is liable for the tax. ▪ Income from local financial instruments is subject to 10% WHT taxation in case of foreign recipients. ▪ Gains / losses from disposal of shares on BG / EU stock-exchange are exempt from taxation.] 1. The general tax treatment applies; 2. Yes – there is a difference in the tax treatment between financial and non-financial institutions. Financial institutions recognise the gains/losses from financial instruments when incurred whereas non-financial institutions upon write-off (i.e. disposal / expiry of the instrument). Based on the example, the difference can be explained as follows: At the year-end the FS institution should recognise gain of 200 which will be taxable. A non-FS company will also recognise a gain of 200 but it will not be taxable at the year end (through an adjustment in the annual CIT). Upon payment of 300 an FS institution will recognise additional taxable income of 100, while a non-FS company will recognise an income of 300 which will be taxable. 3. Flows are taxed at the normal CIT rate of 10% when actually received. 4. Deductible when actually made. 5. The equalization payment (i.e. in the example, the net payment of 300) to a non-resident under a swap may qualify as income from a local financial instrument which is subject to 10% local WHT. The link is "income from local financial instrument" (applied when a party to a swap is a Bulgarian tax resident). Under local law WHT is imposed on any income from financial instruments. Therefore, under broad interpretation the equalization payment may be treatment as

BULGARIA	
	income from local financial instrument subject to WHT. (Unofficially the revenue authorities have expressed such views on different occasions, though it cannot be said there are established practices in this respect). 6. The local rules levy tax on gains from disposal of local financial instruments. If the swap qualifies as a local financial instrument, any gains will be taxed with 10% corporate income taxation. 7. The equalization payment under item 5 may be exempt from taxation as business profit (at least these are the practices we have seen). Gains from sale are treated as capital gains for double tax treaty purposes.

BULGARIA	
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. No specific rules – general regime applies. 2. For financial institutions gains/losses are recognised when incurred. 3. For the rest (i.e. non financial institutions) when expired, i.e. when the transaction is actually settled (upon delivery) – please refer to our comments on B2 above. 4. Yes. 5. May be seen as income from local financial instruments. The link is a Bulgarian resident party to a contract. 6. Capital gains. The party to the contract. 7. Item 5 – business profits. Item 6 - capital

BULGARIA	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. No specific rules – general regime applies. 2. For financial institutions gains/ losses recognised when incurred. For the rest when expired.

BULGARIA

E. Corporate income tax treatment of Call options on stocks in the hands of the holders

BULGARIA	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (x) exercise of the options, (xi) sale of the shares acquired through the option, (xii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	1. Deductible when expired, i.e. upon expiration of the option and upon exercise. 2. Year end gains / losses from measurement of the recognised asset/liability (mark-to-market) are recognised when incurred for financial institutions. For non-financial institutions are recognised upon expiry / exercise. 3. Yes, if the option is exercised, then the premium is part of the acquisition price. 4. (i) – any difference recognised in the financial statements and taxable/deductible accordingly (ii) – part of the purchased shares (iii) – general rules (the call option payment is part of the acquisition cost) (iv) - deductible 5. Yes. 6. It may qualify as income from local financial instrument, which is subject to 10% local WHT (unless traded on a regulated stock exchange). There is a very broad definition on taxable income from financial institutions; this is the reason for a WHT to apply. 7. Business profits. 8. No explicit rules – the general regime should apply.

BULGARIA	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. Taxable upon expiry 2. Yes – year end market valuations taxable / deductible for financial institutions when incurred. For the rest when expired 3. Yes. Based on the example provided, the tax treatment would follow the accounting treatment. To the best of our knowledge the accounting treatment will be a premium of 10 and a gain of 20. 4. Yes 5. Yes
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No
H. Practices	
For all the above conditions is there any information as whether actual practices	To the best of our knowledge no. Though we may say that it could hardly be claimed that there are consistent practices in Bulgaria with this type of

BULGARIA	
may differ from legal provisions?	transactions.

CYPRUS	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. Stamp Duty 2. Stamp duty may apply on issuance of securities or on agreements in relation to sale of securities. Agreements for the sale of securities are exempt if listed in any recognised stock exchange (which certifies the relevant transaction). 3. Stamp Duty Law L19/1963 4. Contract Value 5. Rate of 0,15% (on the first €170,860) plus 0,2% (on amounts over €170,860). On contracts without fixed sum the amount of stamp duty is €34,17. Stamp duty is capped at €17,086, may arise under circumstances on transfers of securities issued by Cyprus resident companies. Stamp Duty is applicable on agreements relating to assets or matters in Cyprus. Agreements on assets/matters outside Cyprus are not subject to Stamp Duty. Agreements on securities of non Cypriot companies should not be considered as assets in Cyprus. Where the agreement is subject to stamp duty, such duty is capped in all cases, for documents effected from 14 August 2007 onwards at €17,086. 6. The date of effecting the agreement (unless the agreement is effected outside the Republic of Cyprus, in which date the date that it is brought in the Republic of Cyprus). Stamp duty is applicable on the agreement and not on the transaction. As such the date of the agreement is the important one as opposed to the date that the transfer is effected. 7. Agreements relating to assets or matters in the Republic of Cyprus. 8. The buyer unless otherwise stated in the agreement.

CYPRUS	
	1. Levy on transactions effected in respect of securities listed in the Cyprus Stock Exchange 2. In scope: 'titles' meaning shares, stocks, debentures, founding and other titles of companies or other legal persons, that have been incorporated in Cyprus or abroad, as well as rights thereon, that are listed on the Stock Exchange Exemptions: (a) the issue and redemption of titles from the issuer (b) transactions involving corporate debentures (c) transactions involving corporate bonds (d) transactions involving debentures, government registered development debentures and treasury bills (e) donations involving titles, which are effected from parent to child, whether married or not, between husbands and wives or between relatives up to third degree kindredness, whether these persons are married or single (f) transfers of titles due to death (g) transactions effected outside the stock exchange (eg. Over the Counter - OTC) that relate to transfer of titles of the same beneficiary between different custodians (re-registration), lending of titles, return from lending, provision of guarantees and return of guarantees (h) transactions that are effected by Market Makers (under conditions) 3. Law 161 (I)/99 (as amended) - Law that provides for the levy of special duty on stock exchange transactions. This legislation is enforced from 1st January 2000 and it ceases to be in effect from 31 December 2011.

CYPRUS	
	4. (a) For the transactions effected within the Stock Exchange the tax base is the amount of the value of the transaction (b) For any other transaction that is subject to the duty and is announced in the Stock Exchange as per the relevant legislation, the tax base is the value of the titles on the day of the announcement in the Stock Exchange based on the closing price of the titles on the day of the announcement or if no such price exists, based on the last existing closing price or based on the announced price, whichever price of the above is the higher. 5. 0,15%; No maximum amount 6. Transactions that are effected in the Stock Exchange and transactions that are announced in the Stock Exchange. 7. On titles that are listed in the Cyprus Stock Exchange. 8. Liable to levying: The Stock Exchange is responsible for the imposition and collection of the duty and remittance of the duty to the government. The remittance is to accompanied by all relevant documentation analysis and information that the accountant general of the Republic may request that support the relevant duty. In cases of transactions effected, the Stock Exchange transfers the liability that is due and collects such liability from the member of the Stock Exchange that effects the transaction on behalf of the seller. The member transfers such amount to the seller and collects it from the sale proceeds. In relation to transactions announced in the Stock Exchange, the Stock Exchange collects the duty from the announcer. Liable to support: The seller or the person that announces the transaction, depending on the circumstances. Rem: a Capital Gains tax at the rate of 20% may arise on gains from the

CYPRUS	
	disposal of shares of companies that own immovable property in Cyprus to the extent that the gain reflects appreciations in the immovable property. This is not applicable in cases where the company's shares are listed in any recognised stock exchange. There are no specific provisions in the legislation addressing how any such capital gains may be triggered in the context of financial instruments.

CYPRUS	
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	There are no specific provisions in relation to the tax treatment of equity swaps in the Cyprus income tax legislation. The comments provided below are **high level** (not seeking to analyse any risks or considerations) and reflect our assessment of the current interpretation of the authorities. 1. The general regime applies. 2. No 3. For equity swaps, according to the current interpretation of the income tax office (as supported by a relevant tax Circular), any profit from equity swaps is not taxable. For equity swaps, according to the current interpretation of the income tax office, any loss from equity swaps is non deductible. 3 + 4: The reason explaining the absence of taxation: Equity swaps fall under the definition of 'titles' as per a tax circular issued by the Cyprus tax authorities. As per the legislation, any profit from the disposal of 'titles' is tax exempt. There is no specific reference to the treatment of the loss. The tax authorities' position is that as the profit is not taxable, any loss is non-deductible. 4. No WHT 5. No WHT 6. There are no WHT, thus there is no specific practice in respect to where such gains/losses are classified.

CYPRUS

C. Corporate income tax treatment of Financial Futures

CYPRUS	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	There are no specific provisions in relation to the tax treatment of futures in the Cyprus income tax legislation. The comments provided below are high level (not seeking to analyse any risks or considerations) and reflect our assessment of the current interpretation of the authorities. 1. The general regime applies 2. No 3. As per the legislation, if the underlying asset is shares, bonds, debentures, founders shares, other titles issued by companies /legal persons, or rights there on (all the above jointly referred to as **"titles"**) then any gain is exempt from income tax (a tax circular has been issued by the authorities setting out examples of securities that fall into the definition of titles). Futures on titles are considered as titles. Otherwise if the future is not on a title, any gain is taxable at the normal CIT rate of 10% (e.g. futures on forex / commodities). The interest on financial futures is expected to be taxable (either at the rate of 10% under income tax after deduction of any expenses wholly and exclusively for the generation of the income **or alternatively** under circumstances under circumstances at the rate of 10% on the gross interest under special contribution for defence). 4. As per the interpretation of the authorities, where any gain is not taxable, any loss is not deductible (i.e. for futures on titles, the loss is non deductible). For futures on non qualifying titles, they are considered as deductible. 5. Mark to Market is not applied – taxation if applicable is on realisation. 6. No WHT are applicable 7. No WHT are applicable 8. There are no WHT, thus there is no specific practice in respect to where such gains/losses are classified.

CYPRUS	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. The general regime applies 2. No

CYPRUS

E. Corporate income tax treatment of Call options on stocks in the hands of the holders

CYPRUS

This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer.

1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?
2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector?
3. Is the premium paid part of the stock acquisition price?
4. Please describe the tax treatment of the gains or losses realised at the following events:
   - (i) disposal of the options,
   - (xiii) exercise of the options,
   - (xiv) sale of the shares acquired through the option,
   - (xv) expiration of option (without exercise or disposal)
5. Is mark-to-market applied?
6. Is there a WHT on premium to non-residents?
7. How are the premium payments classified under the double tax treaties?
8. How are options treated when they are part of a packaged product (e.g. equity linked note)?

There are no specific provisions in relation to the tax treatment of calls in the Cyprus income tax legislation. The comments provided below are high level (not seeking to analyse any risks or considerations) and reflect our assessment of the current interpretation of the authorities.

For the purposes of this analysis it is understood that the term stocks in the question, refers to shares.

1. As per a ruling issued by the tax authorities on a specific transaction, the position expressed is that the premium received is non taxable (and as per their general interpretation on "titles" any premium paid should be expected to be non deductible. This is on the basis that any gain on disposal of a call on securities qualifying as "titles" is non taxable.
2. No
3. Not stated in the legislation but effectively should be regarded to be.
4. (i) Exempt

   (ii) No reference in the legislation, as per a ruling issued on a specific transaction it is treated as a disposal and thus exempt.

   (iii) Exempt unless acquired through a share option scheme in which case a benefit in kind may be applicable on the holder/employee subject to the circumstances.

   (iv) No gain can arise for a holder from non exercise, the premium already paid for the acquisition is expected to be treated as non deductible.
5. No mark to market applies
6. No WHT
7. There are no WHT, thus there is no specific practice in respect to where such gains/losses are classified.
8. As long as the underlying asset is titles (e.g. shares) the options should be treated as regular calls on shares as analysed above.

CYPRUS	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	For the purposes of this analysis it is understood that the term stocks in the question, refers to shares. 1. As per a ruling issued by the tax authorities on a specific transaction, the position expressed is that the premium received is non taxable 2. No 3. Not stated in the legislation but effectively should be regarded to be. 4. No 5. No Mark to Market
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No

CYPRUS	
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	The Cyprus tax legislation does not provide extensive specific provisions in relation to the treatment of financial instruments. The legislation is to a certain extent principle based. For example as per the legislation, any gains on titles are not taxable. The legislation is silent in relation to losses, however the practice followed by the tax authorities is that they are non deductible.

CZECH REPUBLIC	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	At present there is not any special kind of securities transaction tax levied in the Czech Republic on any type of financial instruments.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	1. There are not any specific tax rules laid down for swap transactions or other derivates. Corporate income tax treatment of swap transactions for taxpayers keeping Czech double-entry accounting records (hereinafter"tax residents") follows the accounting rules that are practically the same as IAS 39. As regards taxpayers not obliged to keep accounting records under the Czech accounting rules (hereinafter "tax non residents") tax provisions regarding the income from investment instruments should be applied – in this situation the payment abroad in case of the tax resident counterparty may be subject to taxation based on the cash-

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1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	flow (instead of accrual basis as in case of tax residents). 2. No. 3. Tax treatment of flows of payments under the swap is different for tax residents and for tax non-residents. Tax residents are taxed on the accrual basis in corporate tax base at standard 19% tax rate. It means that the market value of swap at year-end impacts the tax base. Under the accounting rules they generally recognise financial derivatives on the balance sheet at fair value, with the corresponding changes in their fair value recognised in the profit & loss account (except for cash-flow hedges booked to equity). Changes in the fair market value of a derivate instrument are relevant also for tax purposes. Tax non-residents may be taxed on the cash basis, however in case of equity swaps the Czech Republic does not exercises the right to tax income from such swaps (contrary to interest-like income from Interest Rate Swaps) –income from equity swaps (exchange of cash flows) is not considered as Czech source income. 4. For tax residents flows of payments are generally tax deductible on an accrual basis (the market value of swap at year-end impacts the tax base). For tax purposes changes in the fair market value of a swap instrument booked to profit & loss account are relevant. It means that tax law follows accounting law, which is closed to IAS/IFRS and that profits booked in P/L are taxable and losses are deductible. 5. Under the Czech income tax Act, as far as it is not interest like income, the income resulting from payments to non residents under the equity swap is not considered as Czech source income (regardless of the source of payment or shares) and therefore is not subject to taxation in the Czech Republic. 6. Under the Czech income tax Act income coming from sale (but not settlement during the holding period) of a swap is a Czech source income from sale of investment instruments if sold to the Czech tax resident or to the PE of tax non resident (thus not applicable for transactions between two non-residents in case the underlying shares have been issued by a Czech taxpayer). This kind of income is

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	not subject to WHT, but so called tax securement in the amount of 1% of gross proceeds that is paid by the Czech tax resident to the Czech tax office and 99% is paid to the tax EEA non-resident. Tax EEA non-resident has the option to file corporate income tax return and tax the gain at 19% standard corporate income tax rate if it is more beneficial for him. EEA resident is obliged to file corporate income tax return and tax the gains at 19% standard corporate income tax rate. The Czech tax rules may be overridden by the applicable double tax treaty. Tax residency and beneficial ownership are crucial factors to determine tax jurisdiction of the recipient in case of the treaty country. 7. It is not possible to give one universally applicable answer. Classification of the payments may vary depending on concrete formulation of the double tax treaty. Generally income under question 5 is usually considered to be other income under the double tax treaties. Income under question 6 should be considered as capital gain.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate.	From the market practice we understand that "forward rate agreement" ("FRA") that is traded on the stock exchange is called "future on interest rate" (standardised contract, deposit margin is required etc.). FRA is rather a tailor made contract traded OTC. Based on the above and your description of the Financial Future we understand that Financial Future may equal to our understanding of FRA. 1. The rules are the same as for equity swaps. There are not any specific tax rules

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1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	laid down for Financial Futures. Corporate income tax treatment of tax residents follows the accounting rules. Tax residents are taxed on the accrual basis in corporate tax base at standard tax rate. It means that the market value of Financial Futures at year-end impacts the tax base. As regards tax non residents special tax provisions regarding the interest-like income from Financial Futures or sale of Financial Futures should be applied (see below). 2. No. 3. The moment of taxation of gains and losses is different for tax residents and for tax non-residents. - Tax residents follow accounting rules. Changes in the fair value of Financial Futures and settlement at sale are recognised in the profit and loss account, and are also relevant for tax purposes. - Tax non-residents are taxed on the cash basis. Gains or losses resulting from holding of Financial Futures may be classified as interest-like income subject to 15% local WHT that may be overridden by the relevant double taxation treaty. In such a case the income is usually considered as Other income. 4. Yes, for tax residents. Non-residents book the Financial Futures in their books according to their accounting rules. 5. Tax non residents are taxed on cash basis. In case there will be any taxable income upon the expiration other than income from sale of the futures, it should be classified as interest-like income subject to 15% WHT (unless the Czech tax rules are not further overridden by the applicable double tax treaty). 6. Under the Czech Income Tax Act income coming from sale of Financial Future is a Czech source income from sale of investment instruments if sold to the Czech tax resident. This kind of income is subject to tax securement in the amount of 1% of gross proceeds that is paid by the Czech tax resident to the Czech tax office and

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	99% is paid to the tax EEA non-resident. Tax EEA non-resident has the option to file corporate income tax return and tax the gain at 19% standard corporate income tax rate if it is more beneficial for him. EEA resident is obliged to file corporate income tax return and tax the gains at 19% standard corporate income tax rate. The Czech tax rules may be overridden by the applicable double tax treaty. Tax residency and beneficial ownership are crucial factors to determine tax jurisdiction of the recipient in case of the treaty country. 7. It is not possible to give one universally applicable answer. Classification of the payments may vary depending on concrete formulation of the double tax treaty. Generally income under question 5 is usually considered to be other income under the double tax treaties. Income under question 6 should be considered as capital gain.

CZECH REPUBLIC	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. There are not any tax rules laid down specifically for call options. Our comments on Financial Futures apply to the Call options. 2. No.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
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option on stocks is the option buyer.

1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?

2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector?

3. Is the premium paid part of the stock acquisition price?

4. Please describe the tax treatment of the gains or losses realised at the following events:

   (i) disposal of the options,

   (xvi) exercise of the options,

   (xvii) sale of the shares acquired through the option,

   (xviii) expiration of option (without exercise or disposal)

5. Is mark-to-market applied?

6. Is there a WHT on premium to non-residents?

7. How are the premium payments classified under the double tax treaties?

8. How are options treated when they are part of a packaged product (e.g. equity linked note)?

accounting is applied).

4. (i) According to the Czech accounting and tax rules, tax residents gain/losses realised at disposal of the options enter the tax base on accrual bases. Income of tax non residents from disposal of the option should be taxed in the Czech Republic under the condition that the option is sold to the Czech tax resident. This kind of income is subject to the tax securement in the amount of 1% of gross proceeds that is paid by the Czech tax non-resident to the Czech tax office and 99% is paid to the EEA tax non-resident. Tax EEA non-resident has the option to file corporate income tax return and tax the gain at 19% standard corporate income tax rate if it is more beneficial for him. EEA resident is obliged to file corporate income tax return and tax the gains at 19% standard corporate income tax rate. The Czech tax rules may be overridden by the applicable double tax treaty.

   (ii) Gains/losses realised by tax residents at the exercise of the option enter the tax base as part of the fair market valuation of a Call option. Exercise of the option should not give rise to any taxation of the tax non residents on the option.

   (iii) According to Czech tax rules sale of shares is considered to be taxable income of tax residents. It would be possible to declare the purchase price of shares as tax deductible expense. If shares are sold by tax non resident to the Czech tax resident, the income is subject to the tax securement in the amount of 1% of gross proceeds that is paid by the Czech tax non-resident to the Czech tax office and 99% is paid to the tax non-resident. Tax EEA non-resident has the option to file corporate income tax return and tax the gain at 19% standard corporate income tax rate if it is more beneficial for him. EEA resident is obliged to file corporate income tax return and tax the gains at 19% standard corporate income tax rate.The Czech tax rules may be overridden by the applicable double tax treaty.

   If the shares are sold between two non-residents and the gains realized on the transfer of shares in Czech companies, the non-resident seller should tax the gain at 19% via a tax return. Czech tax rules can be overridden by the applicable double

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	tax treaty. (iv) Gains/losses realised by tax residents at the expiration of the option enters the tax base as part of the fair market valuation of a Call option. As far as tax non resident is taxed on cash basis, expiration of options should not rise any Czech taxable income for non resident. 5. Yes, for tax residents. 6. The premium paid by a tax resident to EEA non-residents should be taxed as income from sale of investment instruments being subject to 1% securement with an option to file a tax return in the Czech Republic (questionable may be cost associated with this income). EEA resident is obliged to file corporate income tax return and tax the gains at 19% standard corporate income tax rate. 7. In general premium payments should be classified as other income under the double tax treaties. 8. The option may be accounted separately, if it is classified in the accounting as embedded derivative – the tax treatment follows the accounting treatment. If the option is not classified as embedded derivative, taxation follows the tax treatment of the main product.

CZECH REPUBLIC	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. Tax residents follow the Czech accounting rules- premium received are taxable on an accrual basis, i.e. when released to the profit & loss account. For tax purposes changes in the fair market value of Call option are relevant. Thus premium is not taxable/tax deductible upon reception/payment, but when it enters the tax base as part of the fair market valuation or expiration of the option. Premium received by tax non residents – see point 6. in the section E. 2. No 3. Only in some cases when the hedge accounting is applied. 4. In case of tax residents gain is taxed via booking of fair valuation to the profit & loss account. Exercise of the option should not give rise to any taxation of the tax non residents as they are taxed on cash basis. 5. Yes, for tax residents.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No, as far as the institution is accounting entity under the Czech accounting rules.

CZECH REPUBLIC	
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	We are not aware of any.

DENMARK	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. No transactions taxes are levied on transfers of financial instruments.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the	[General comments to be kept in mind in the rest of the questionnaire: We have based our answers on the following: ▪ Unless specified the companies trading the financial contracts are tax liable to Denmark.

applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.

1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)?

2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?

3. Are the flows of payments received taxed, if yes, when and how?

4. Are the flows of payments made tax deductible, if yes, when and how?

5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax?

6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax?

7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?

- the shares – being the underlying assets of the financial instruments – are traded on an exchange

- companies entering into the financial contracts will at no time exceed a share interest of 10% in the companies, which shares are the underlying assets of the financial contracts

- Unless specified the shares are not delivered under the contract i.e. the contracts are closed before expiry

From a Danish tax point of view it is important to determine if the shares (underlying asset) are delivered under the contract or not. If the shares are delivered the contract will be taxed under the same rules as shares (in coherence with the underlying asset). If the shares are not delivered or the contract expires without exercise, the contract will be taxed separately according to a mark-to-market principle.

Under the general Danish tax rules for Danish companies entering into financial contracts (when the financial contract is taxed separately and not together with the underlying asset) gains or losses will be taxed according to a mark-to-market principle. This means that both unrealised as well as realised gains or losses would be included in the tax base. The tax base would correspond to any fluctuations between the point of entering into the contract and the point of expiry/exercise of the contract. Should a contract period cover more than one income year, taxation in the first income year would cover fluctuations between the point of entering into the contract and year-end. Taxation in the subsequent income year would cover fluctuations between the first day of the income year and the time of expiry/exercise or year-end (if the contract still continues).]

1. The general tax regime applies (cf. above), and any profits will be taxable while losses

DENMARK	
	will be tax deductible according to a mark-to-market principle, i.e. on an unrealised basis. The CIT rate is 25%. 2. Same as item 1), We confirm there is no difference between FS and non-FS sector. 3. The swap will be taxed on a mark-to-market principle, i.e. on an unrealised basis, with reference to any fluctuations in the value of the equity swap 4. Same as item 3) – 5. No. 6. No. 7. N/A

DENMARK	
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. The general tax regime applies (cf. above under section D), and any profits will be taxable while losses will be tax deductible according to a mark-to-market principle, i.e. on an unrealised basis. 2. Same as item 1) 3. Gains and losses are taxed according to mark-to-market principle, i.e. on an unrealised basis. 4. Yes 5. No. 6. No. 7. N/A

DENMARK	
D. Corporate income tax treatment of Call options on stocks in general	
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E. Corporate income tax treatment of Call options on stocks in the hands of the holders

DENMARK	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xix) exercise of the options, (xx) sale of the shares acquired through the option, (xxi) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	1. Due to the mark-to-market principle the premium paid would be tax deductible in the income year where the option is acquired. Any other fluctuations would also be taxable/deductible for each income year. 2. The mark-to-market principle would still apply 3. We understand that, in this case, the underlying asset has been delivered under the contract. Provided the contract has not been transferred to other counterparties, the option contract would be taxed together with the underlying asset, i.e. the stock. The premium paid would in general be part of the acquisition price of the stock. Given that the shareholding does not exceed 10%, the shares will be taxed on a mark-to-market principle. 4. (i) Taxed according to a mark-to-market principle (ii) Taxed according to a mark-to-market principle (iii) Any profit or loss as a result of selling the shares would be taxed as a capital gain/loss on shares. Capital gains on shares that qualify as "portfolio shares" are taxable while capital losses are deductible. The CIT rate is 25%. (iv) Taxed according to mark-to-market principle 5. Mark-to-market principle is applied in relation to taxation of the call option. The premium which was paid for the option is tax deductible in the income year where the option is acquired (if mark-to-market principle applies) 6. No. 7. N/A 8. N/A

DENMARK	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. The premium for the writer would be taxable under the ordinary corporate income tax rules. The premium received, including any value adjustments, for the option is taxable in the income year where the option is issued (if mark-to-market principle applies) at 25%. 2. No. 3. The call option would be taxed separately and the premium would be taxed under the ordinary corporate income tax rules. The CIT rate is 25%. Referring to the example: We will base our answer on the assumption that the issuer wants to hedge any exposure on the share which is already acquired at a spot price of 80, that the option has been entered into in order to deliver the underlying asset (the share acquired) to a third party at fixed strike price and that the issuer do not exceed a share interest of 10%. As mentioned above, a financial contract is subject to a case by case assessment on whether it is a financial contract (and taxed separately from the underlying asset) or covered by the exemptions to the rules (and taxed together with the underlying asset). Based on the above, we assume that the contract would be taxed separately from the underlying asset, i.e. that the contract does not fulfil the requirements for being exempted from the tax rules for financial contracts. The issuer would be taxed on a gain on the financial contract of 10 (the premium) and separately on a gain on the share of 20. (If the shareholding would exceed 10%, any gains on shares would be tax free.). If the financial contract would fall under the exemptions from the rules for financial contracts, the contract would be taxed under the same rules as the underlying asset, i.e. as part of the shares. 4. The counterparties in a call option contract would be taxed upon exercise under the

DENMARK	
	general tax rules for financial contracts. The writer would be taxed on capital gains or losses on stocks when making the asset available at strike price. 5. Yes.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	N/A

ESTONIA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	There is no securities transaction tax in Estonia.

ESTONIA	
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. In Estonia, the general tax regime applies and there are no specific tax rules applicable to swap transactions. 2. None. 3. Under the existing Estonian corporate tax regime, any undistributed profits are exempt from corporate taxation, until company makes actual or hidden profit distributions. Thus, the 21% corporate tax is deferred until the distribution of profits. Thus, the payment received under the swap will be subject to tax at the normal CIT rate of 21%, but only upon distribution. 4. There are no specific tax rules for the deduction of flows of payment. Distributable profits are determined by financial statements drawn up in accordance with Estonian GAAP or IAS/IFRS and there is no adjustment of accounting profits for tax purposes. Thus, swap payment is a deductible expense in the absence of specific deviating tax rules. 5. None. 6. None. 7. There is no prevailing practice, but most likely these payments are classified as capital gains or other income under double tax treaties. In the absence of realisation/transfer, these payments may be classified as other income, but under most Estonian tax treaties there is no source country taxation of other income. There is no taxation of such income derived by non-residents under the domestic law.

ESTONIA	
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. In Estonia, the general tax regime applies and there are no specific tax rules applicable to financial future transactions (regardless whether the parties are companies in the Financial Sector). 2. None. 3. Under the existing Estonian corporate tax regime, any undistributed profits are exempt from corporate taxation, until company makes actual or hidden profit distributions. Thus, the 21% corporate tax is deferred until the distribution of profits. There is no calculation of tax losses (this means that in the absence of annual taxation of undistributed profits, as only distributions are subject to corporate tax, there is no adjustment of accounting profits/losses for tax purposes). Thus, the payment received under the futures will be subject to tax at the normal CIT rate of 21%, but only upon distribution. 4. Yes, accounting treatment is followed. No taxation until profit distributions. 5. None. 6. None. 7. There is no prevailing practice, but most likely these payments are classified as capital gains under double tax treaties.

ESTONIA	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the rright but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. In Estonia, the general tax regime applies and there are no specific tax rules applicable to call options on stocks transactions. 2. None.

ESTONIA

E. Corporate income tax treatment of Call options on stocks in the hands of the holders

ESTONIA	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xxii) exercise of the options, (xxiii) sale of the shares acquired through the option, (xxiv) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	1. The premium paid should be deductible upon expiration. 2. None. 3. Yes. 4. Under the existing Estonian corporate tax regime, any undistributed profits are exempt from corporate taxation, until company makes actual or hidden profit distributions. Thus, the 21% corporate tax is deferred until the distribution of profits. There is no calculation of tax losses (this means that in the absence of annual taxation of undistributed profits, as only distributions are subject to corporate tax, there is no adjustment of accounting profits/losses for tax purposes). If we assume that the value of the shares at maturity is 80, then the holder has suffered a loss of 10 (being the premium paid, in the absence of exercise of the option in such case). This loss is "deductible" in the sense that there will be no adjustment of accounting losses for tax purposes. 5. Yes, accounting treatment is followed. No taxation until profit distributions. 6. None. 7. There is no prevailing practice, but most likely these payments are classified as other income under double tax treaties. In the absence of realisation/transfer, these payments may be classified as other income. In both cases, under most tax treaties there is no source country taxation in Estonia. There is no taxation of such income derived by non-residents under the domestic law 8. In the absence of specific tax rules, the general rules should apply.

ESTONIA	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. In Estonia, the general tax regime applies and there are no specific tax rules applicable to premium received. Such income is taxable upon the distribution of profits by the company. 2. None. 3. No rules, but likely it is not part of stock delivery price. 4. Under the existing Estonian corporate tax regime, any undistributed profits are exempt from corporate taxation, until company makes actual or hidden profit distributions. Thus, the 21% corporate tax is deferred until the distribution of profits. There is no calculation of tax losses (this means that in the absence of annual taxation of undistributed profits, as only distributions are subject to corporate tax, there is no adjustment of accounting profits/losses for tax purposes). 5. Yes, accounting treatment is followed. No taxation until profit distributions.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No

ESTONIA	
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	As there are no specific legal provisions, general rules apply.

FINLAND	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. Transfer of certain Finnish securities, mainly equities (e.g. on the basis of delivery of the underlying of an equity derivative), may be subject to transfer tax in case the transferee and/or transferor is a Finnish resident or a Finnish branch of certain financial institutions. However, there are several exceptions, e.g. no transfer tax is payable if the equities in question are subject to trading on a qualifying market (even if the transfer is carried out as an OTC transaction). 2. Broadly: equities, profit participating loans, options to subscribe for shares. No transfer tax is applicable to bonds, other debt securities and derivatives. For derivatives, note the comment on delivery of the underlying. 3. Transfer Tax Act (29.11.1996/931) as amended 4. Sales price or other consideration. 5. 1.6% 6. Transfer of legal title 7. See above 8. Generally the transferee (or the broker in some cases)

FINLAND	
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. General tax regime applies. The standard CIT rate is 26%. 2. No, general tax regime applies (note that banks more typically apply the mark-to-market accounting and tax treatment mentioned below). 3. Yes, generally under realisation principle. However, broadly, if the mark-to-market treatment is applied in accounting, then also the tax treatment will follow the mark-to-market treatment (consequence: taxation/deduction at year-end even if not any payments/realisation yet) under certain conditions (broadly, these conditions depend, e.g. for banks, the instrument must be regarded as held for trading purposes). 4. Yes, upon realisation principle. However, see the mark-to-market tax treatment above. Furthermore, broadly, losses from OTC derivatives may not be deductible in case allocated to the non-business basket (in practice, FS sector companies very rarely have a non-business basket). 5. Generally no. 6. Generally no. 5+6: Note that anti-abuse rules could be applicable to transactions aimed at avoiding Finnish WHT. Also, in certain cases, a dividend equivalent amount under an equity swap could be potentially characterised as “manufactured dividend” for Finnish tax purposes in which case WHT could be payable. 7. There is no published legal practice and therefore the matter is open to interpretation (alternative interpretations: business income, capital gains, other income).

FINLAND	
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. General tax regime applies. The standard CIT rate is 26%. 2. No, general tax regime applies (note that banks more typically apply the mark-to-market accounting and tax treatment mentioned below). 3. Yes, generally under realisation principle. Broadly, if mark-to-market treatment is applied in accounting, then also the tax treatment will follow the mark-to-market treatment (consequence: taxation / deduction at year-end even if not any payments / realisation yet) under certain conditions (broadly, these conditions depend, e.g. for banks, the instrument must be regarded as held for trading purposes). However, broadly, losses from OTC derivatives may not be deductible in case allocated to the non-business basket. 4. See previous answer. 5. Generally no. 6. Generally no. 7. There is no published legal practice and therefore open to interpretation.

FINLAND	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a rformal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. General regime applies. 2. No (note that banks more typically apply the mark-to-market accounting and tax treatment mentioned below).

FINLAND

E. Corporate income tax treatment of Call options on stocks in the hands of the holders

FINLAND	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xxv) exercise of the options, (xxvi) sale of the shares acquired through the option, (xxvii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	1. The premium is tax deductible in the tax year when the option contract is exercised, expired or closed out. If the contract is marked-to-market in accounting, the taxation follows the accounting treatment under certain conditions. 2. Generally no (note that banks might typically apply the above mark-to-market accounting and tax treatment). 3. Yes. 4. (i) Sales price taxable income, acquisition cost (premium) tax deductible. (ii) If cash settled, received cash settlement is taxable income and the acquisition cost (premium paid) tax deductible. In a physical delivery of shares, the acquisition cost of the equities purchased on the basis of the options equals the strike price plus the premium paid for the option. (iii) Sales price taxable income, acquisition cost (premium + strike) tax deductible. (iv) Premium should be tax deductible. However, broadly, losses from OTC derivatives may not be deductible in case allocated to the non-business basket. 5. Generally taxation follows realisation principle. However, if marked-to-market treatment is applied in accounting, then also the tax treatment will follow accounting treatment under certain conditions. 6. Generally no. 7. There is no published legal practise and therefore open to interpretation 8. The packed product is typically not divided (“bifurcated”) into elements; e.g. a structured note is seen as one product and taxed accordingly (i.e. the option element in the structured note is not taxed as a separate option contract)

FINLAND	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. In case the option contract is publicly traded and the maturity thereof is 18 months or less, the premium is taxable in the tax year when the option is exercised, expired or closed out (this refers to "closing out" by entering into an opposite derivative with same terms (e.g. a long call can be closed out by entering into a short call)). In other words, there is a deferral of taxation of the premium received. In other cases (e.g. OTC options), the premium is taxable when received. No deferral thus and no spread of the premium over the life time of the option. If the contract is marked-to-market in accounting, the taxation follows the accounting treatment under certain conditions. 2. Generally no (note that banks more typically apply the above mark-to-market accounting and tax treatment). 3. No. In the example, 10 will be taxed as a premium received and 20 as a gain on shares 4. Yes. 5. See above.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No

FINLAND	
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No

FRANCE	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	For the purpose of the developments below, please note that a financial instrument is treated as "listed" when it is traded on a regulated market or traded by reference to a regulated market (i.e. the underlying asset is traded on regulated market). 1. Yes 2+5+6: As a matter of principle, there are no transaction taxes or registration duties upon disposal: ▪ of derivatives, or ▪ of stocks provided the transactions are performed on a stock exchange market. However, listed stocks (i.e. "actions") transferred in a written deed (which remains remote in practice) and non listed stocks (transferred under any form) are subject to a 3% registration duty capped at EUR 5,000. Shares (i.e. "parts sociales") are subject to the same tax. Transfer of shareholding in real estate companies (i.e. companies mainly owning real estate assets) is subject to a 5% registration tax. For transfer of bonds the registration tax will be a lump sum amounting to EUR 125. 3. Article 726 of the French Tax Code ("FTC") for shares/stocks. Article 680 of the FTC for bonds. 4+6. Above registration tax applies on transactions qualifying as a disposal of shares; taxation basis is the selling price. For shares, the tax is

FRANCE	
	computed after applying a EUR 23,000 reduction on the selling price (on a pro rata basis on the number of shares effectively transferred). The EUR 23,000 reduction is computed on the entire share capital of the SARL. Should 100% of the share capital be sold at EUR 25,000, the basis of the transfer tax will be EUR 2,000. On the other hand, if only 40% of the share capital is sold for an amount of EUR 25,000, the reduction will reflect the pro rata shares sold: 40% x 23,000 = 9,200. In such case, the effective basis of the registration duties will be: 25,000 – 9,200 = 15,800. 7. The above registration tax applies on transactions performed either: ▪ in France; or ▪ abroad provided the transfer relates to shares/stocks of a French non listed company or of a company mainly holding real estate located in France. The sale of listed shares of French companies realised abroad are outside of the scope of registration tax. 8. The purchaser of the securities is liable for both levying and supporting the tax. However, both the seller and the purchaser are responsible toward the French Tax Authorities ("FTA") for the payment of the tax.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax	1+2 Preliminary comment: there is no provision of French tax law that specifically encompasses the tax treatment of equity swap. General tax regime applies although financial institutions usually apply a tax treatment which differs from the one of non financial companies

FRANCE	
treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	3+4 General rule; taxation of gain / loss components occurs at the completion date of the contract. While flows of payment (whether received or paid) are taken into account on an accrual basis (interest components) or cash basis (dividend component) subject to the application of straddle rules; straddle rules may result in deferring deduction of unrealized losses. If applicable, the "straddle rules" compel companies to defer losses recognised on a position to the extend that there is an unrecognised gain with respect to an offsetting position. The deductibility of a loss realised on a position will be limited to the portion exceeding the latent gain on a linked position. For example, let's assume in year N a position A (derivative) and a position B (asset) are booked at 10 each. Let's also assume that position A is under the mark-to-market valuation rules while position B is not. At the end of the year N+1, position A could be evaluated at 7 (hence generating an unrealised loss of 3) while the value of position B is 12. The unrealised gain of 2 is not taxable. At the closing of year N+1, the company will only be able to deduct the portion of the unrealised loss that will exceed the portion of the unrealised gain, i.e. 3-2 = 1 in our example. The remaining portion of the loss will only be deductible once the profit is taxable. Based on existing tax law, mark-to-market taxation should apply if the equity swap can be treated as "listed" (see above). However, equity swap markets are still considered as not "regulated" so that mark-to-market evaluation is usually not applicable for non financial companies.

FRANCE	
	From an accounting perspective, the charges and profit corresponding to the equity and interest legs of the equity swap may be booked either by netting or making a breakdown of the accounting items. The tax treatment would mainly follow the accounting one. Based on our knowledge, no provision of French tax law require a breakdown of the charges/profit over the equity swap. Financial institutions: Mark-to-market evaluation i.e. taxation (or deduction) of the unrealized gains (or losses) on the equity swap at the closing date of each exercise. As a matter of facts, financial institutions use mark-to-model approach. This practice is in line with the accounting standards as applied by institutions of the Financial Sector. Such procedure is currently not challenged by the FTA. In both cases, the profits are subject to French 33.33% corporate income tax ("CIT"). 5+6. There is currently no provision of French tax law that specifically envisages a WHT on payments made to a foreign entity over a swap agreement. Based on administrative guidelines (issued for interest swap payments), no WHT should be levied. The same reasoning should be duplicated for equity swap. Theoretically, a 33.33% WHT could be levied if the foreign counterparty to the swap is seen as providing a service in France to a French company (a 50% rate is applied for payments made to a service provider located in a Non Cooperative State or Territory - "NCST"[9]). This risk remains remote in practice as most double tax treaties ("DTT") provide for exemption of French tax in such

[9] The 2010 list of NCST has been published on 17 February 2010 and includes: Anguilla, Belize, Brunei, Costa Rica, Dominica, Grenada, Guatemala, Cook Islands, Marshall Island, Liberia, Montserrat, Nauru, Niue, Panama, Philippines, St. Kitts and Nevis, St. Lucia, St Vincent and the Grenadines. Belize may be excluded as it signed an exchange of information agreement on 10 January 2011.

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	a situation. 7. The DTT provisions related to "other income" should apply to payment made on the instrument.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax?	We understand that the D.3. section does not relate to Forex instruments (specific rules applicable to Forex instruments). 1. - Specific rules are applicable - either if the Financial Futures can be treated as "listed" (see above); futures on interest rate are not usually treated as "listed"; - or if Financial Futures used as hedging position so that Straddle rules apply. Financial institutions usually apply a mark-to-market approach (regardless whether the counterparty is another financial or a non financial institution) 1+2+3+4: ▪ For <u>financial institutions</u>: the same rules as described for equity swap would apply, i.e. mark-to-market evaluation resulting in taxation (or deduction) of the unrealized gains (or losses) at each FY closing date. Alternatively, financial institutions may use mark-to-model approach. The tax treatment is mainly driven by the application of the accounting rules specific to institutions of the Financial Sector. ▪ For <u>non financial companies</u>: FRA, CAP, FLOOR, COLLARs

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7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	instruments are usually considered as "non listed" instruments within the meaning above. French companies thus do not apply the mark-to-market rules in practice. Payment flows are taxed/deductible on an accrual basis. The tax rate is the standard CIT rate i.e. 33.33%. The same goes for futures provided those financial futures are not listed. 5+6. Though no written position has been issued, it is admitted that there should be no WHT levied on payments made upon financial futures. As mentioned above for equity swap, a 33.33% WHT might be levied should the contract be assimilated to a service contract provided by a foreign entity to a French tax payer (a 50% rate is applicable for payment made to a service provider located in an NCST). This risk remains remote in practice as most DTTs provide for exemption of French tax in such a situation. 7. The "other income" provision should be used for gains deriving from the financial future agreement.

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D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. Premium paid by the option buyer: According to French tax law, such expense will not be tax deductible **until the date of the effective exercise of the option**. Should the option be listed, the mark-to-market evaluation principle will apply, i.e. evaluation of the option at each financial year closing date and taxation/deduction of latent gains/losses linked to the option (subject to the application of straddle rules). The loss deriving from the aforementioned annual evaluation cannot exceed the amount of the premium initially paid by the holder of the option. 2. For financial institutions (regardless of the type of counterparty): mark-to-market valuation resulting in taxation (or deduction) of the unrealized gains (or losses) at each FY closing date. Alternatively, financial institutions may use mark-to-model approach. The tax treatment is mainly driven by the application of the accounting rules specific to institutions of the Financial Sector.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call	1. See reply 1 to point D above. 2. As mentioned above, banks will usually apply mark-to-market or mark-to-model valuation so that timing of the tax deduction / recognition may be different. 3. Options on non listed stock/shares: premium will be part of the acquisition price. For listed options/options on a listed asset: the premium will not be part of the stock acquisition price and will only, under current French tax principles, reduce the

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option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (xxviii) disposal of the options, (xxix) exercise of the options, (xxx) sale of the shares acquired through the option, (xxxi) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	potential capital gain over the stocks. In other words, assuming the stocks do not qualify for participation exemption regime for capital gains[10]. - In the alternative of non listed options, the premium will increase the acquisition price used to compute the capital gain on the share (if any). - On the other hand, in the alternative of listed options, the acquisition price will not be impacted by the amount of the premium. The company will only be entitled to book, as a charge, the premium initially paid. From a French tax perspective, the capital gain realised at the time of the exercise of the option is taxable at 33.33%, i.e. does not benefit from any specific regime/exemption. The charge resulting from the payment of the premium will be included in the tax P&L of the company hence, at the end of the day, reducing the taxable capital gain. Such treatment is mainly due to the absence of specific treatment of the capital gain realised at the time of exercise of the option. Should this capital gain be specifically treated in the future (i.e. at a specific tax rate), the premium would not "reduce the capital gain" as such but would remain deductible as an expense. In closing, we can say that the result of either booking the premium as a charge or increasing the value of the shares would be the same as in both cases it would end

[10] Qualifying shareholdings (i.e. stocks held for at least 2 years and generally representing 5% of a subsidiary's share capital) are tax exempt save for a 5% lump sum subject to CIT.

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	up reducing the capital gain. However, should French tax principles be changed in the future, it will be critical ensuring the premium is properly booked (i.e. either as a charge or as an increase of the acquisition price of the shares). 4. (i) gain are taxable at 33.33% on the difference between the value of the premium at the time of the agreement and the market value of the premium at the time of the disposal / losses deductible. (ii) For non listed options: see point 3 above. For listed options/options on listed stocks: the option will reduce the amount of the latent capital gain on the stocks (if any) taxed at CIT. When there is no capital gain on the shares to offset the amount of the premium, it will be considered as a general expense, deductible for tax purposes. (iii) taxation of the capital gain on the shares (i.e. difference of the stocks' value at the time of the exercise of the option and the value at the time of the disposal) or deduction of the short term capital loss. Participation exemption regime may apply. (iv) the premium will become deductible. 5. See above - for listed call options/options on listed stocks, the mark-to-market evaluation will be done at each FY closing date. 6. No WHT is levied on premium payment as such. However, a 33.33% WHT could apply if payment of the option is assimilated to the remuneration of a service rendered in France (a 50% rate is applicable for payment made to a service provider located in an NCST). This risk remains remote in practice as most DTTs provide for exemption of French tax in such a situation. 7. Other income (save for specific qualification under a DTT).

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	8. In practice, only the note linked to the underlying investment will bear the taxation unless both the note and the option are separately identified.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. &4. As a general rule, the premium is taxable at French CIT at the time of the exercise of the option. However, in practice, the tax treatment will follow the accounting one, i.e. possible spread of the premium over the duration of the option. 2. As mentioned above, banks will usually apply mark-to-market or mark-to-model valuation so that timing of the tax deduction/recognition may be different 3. Not for listed options/underlying assets. 4. See 1. 5. Yes for listed options/options on listed underlying assets only.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No

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H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	▪ The mark-to-model practice is applied by financial institutions as a substitute to the mark-to-market valuation (where market of the instruments is not fully regulated and specific factors of risk need to be taken into account). ▪ Due to the lack of guidance and tax rules with respect to derivatives, banks have a trend to consider that the tax treatment of the derivative instruments should follow the accounting standards specific to the Financial Sector. For the time being, the FTA do not challenge those practices.

GERMANY	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	Preliminary note: we describe below an "income tax based on capital gains"; rather than a "transaction tax" like a stamp duty in the sense that it would be due on the sale price each time there is a transaction involved, etc. 1. Yes. Security transactions are taxed under the provisions of the German income and corporate income tax law. Special securities transactions taxes do not exist. 2. *Securities in scope:* Shares, jouissance rights, expectancies on such rights (including conversion rights from bonds), participation rights in investment funds and in REITs, dividend and interest coupons, futures (including swaps, forwards, options, currency futures), silent partnerships, participation loans, life insurance claims, and other capital receivables (including fixed interest bonds, financial innovations and certificats) *Securities not in scope:* All securities not falling under one of the subject groupings mentioned above. 3. *Private Investors:* Generally sect. 20 para. 2 German Income Tax Act ("ITA") or if the investor holds within the last five years more than 1% of the capital of a corporation, sect. 17 para. 1 ITA applies expectancies on such rights (including conversion rights from bonds) of that corporation. *Corporations:* Sect. 7 et seq. Corporate Income Tax Act ("CITA"), sect. 20 paras. 2 and 8 ITA, *Other trading investors:* Sect. 20 paras. 2 and 8 ITA, sect. 15 ITA *Self-employed investors:* Sect. 20 paras. 2 and 8 ITA, sect. 19 ITA 4. Taxes are levied on the profit from the transfer of the respective instrument (i.e.

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	income less acquisition costs, initial acquisition costs and transfer related costs). 5. *Private investors:* Generally 25% plus solidarity surcharge of 5.5% thereon and (if applicable) church tax. Under certain circumstances (e.g. capital participation of more than 1% for more than 5 years or lower individual income tax rate) the individual tax rate applies. *Corporations:* Generally 15% CIT plus solidarity surcharge of 5.5% thereon and trade tax dependant on the respective municipality rate. However, income from the sale of shares and jouissance rights is generally 95% tax exempted, unless the seller is a credit or financial institution holding the participations to obtain short term profits. *Other trading entities*: Individual tax rate of the investor whereas 40% of the dividend income is tax free plus trade tax dependant on the respective municipality rate. *Self-employed investors:* Individual tax rate of the respective investor whereas 40% of the capital gains from the sale and purchase of shares dividend income is tax free. 6. Completion of the execution agreement on the transfer of the legal or beneficial ownership of the instrument two a third party against consideration. 7. Generally taxation is linked to the unlimited tax liability of the tax payer due to the residency, habitual abode, seat or place of business in Germany. If there is no domestic link only the sale of shares of a German resident corporation would be subject to taxation, provided the participation in the company's capital exceeds more than 1% within the last five years. 8. Generally the tax is levied by the domestic credit or financial service institution by deducting the tax from the payment made to the recipient. These institutions are also liable for the taxes. Although being the debtor of the taxes the recipient of the income is only liable under specific circumstances.

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	Under certain circumstances (e.g. participation in the company's capital exceeds more than 1% within the last five years) taxes are levied on the base of individual tax declarations.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax?	1. Swap transactions fall under the general tax regime irrespective of the sector of the parties. 2. Taxes are not deducted from the respective income if the recipient is a credit or financial institution. Rather such institutions declare the taxable income in its tax declaration. 3. Settlement payments received from the counter party qualify as profit. Taxes are deducted by the counter party (generally a credit institution) paying the settlement to the recipient. Corporations can credit the deducted tax against the CIT. As outlined under No. 2 this does not apply for credit and financial institutions The standard CIT rate is 15% plus solidarity surcharge of 5,5% thereon. Usually, the taxation occurs on an accruals basis. 4. Payments to the counter party qualify as negative income for tax purposes and are deductible as expenses from settlement payments received by the counter parties. Negative income reduces the tax basis irrespective of the applicable tax profile. 5. No. 6. No. 7. Permanent payments should qualify as "other income". Regarding the income from the sale of swap generally it has to be differentiated: If the underlying value is physically delivered the payment qualifies as "capital gain". On the other hand

[11] Wassermeyer in Wassermeyer/Debatin, Art. 13 MA Rz. 33.

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7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	cash settlements qualify as "other income"[11].However, as under a swap agreement regularly only payments are made the income should qualify as "other income".
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. Financial futures are taxed under the general tax regime irrespective of the sector of the parties. 2. Taxes are not deducted from the respective income if the recipient is a credit or financial institution. Rather such institutions declare the taxable income in their corporate tax declarations. 3. The balance of all payments made or received under the future contract qualifies as taxable profit or loss at the maturity date. Taxes are deducted by the counter party (generally a credit institution) paying a profit (if any) to the recipient. Corporations can credit the deducted tax against the CIT. As outlined under No. 2 this does not apply for credit and financial institutions. 4. Yes. 5. No. 6. No. 7. Permanent payments (if any) should qualify as "other income". Regarding the sale of futures it has to be differentiated: If the underlying value is physically delivered the payment qualifies as "capital gain". On the other hand cash settlements qualify as "other income".

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D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. Call options on stock transactions fall under the general tax regime irrespective of the sector of the parties. 2. No.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call	1. The premium paid qualifies as acquisition costs and is deductible from any cash settlement received when the option right is exercised or it is offset. 2. No. 3. Yes, cf. above. 4. (i) For tax purposes the difference between the received cash settlement less the acquisition costs and incidental acquisition costs qualifies as taxable gain or loss.

option on stocks is the option buyer.

1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?

2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector?

3. Is the premium paid part of the stock acquisition price?

4. Please describe the tax treatment of the gains or losses realised at the following events:

   (i) disposal of the options,

   (xxxii) exercise of the options,

   (xxxiii) sale of the shares acquired through the option,

   (xxxiv) expiration of option (without exercise or disposal)

5. Is mark-to-market applied?

6. Is there a WHT on premium to non-residents?

7. How are the premium payments classified under the double tax treaties?

8. How are options treated when they are part of a packaged product (e.g. equity linked note)?

(ii) If the shares are delivered physically, the exercise of the option and the delivery of the shares should not be subject to taxation. Regarding a later sale of the shares the acquisition costs and incidental acquisition costs of the options are part of the acquisition costs which for tax purposes are deductible from the payment received for a sale of the shares.

If a cash settlement is received instead of the shares the acquisition costs and incidental acquisition costs are deductible from the cash settlement for tax purposes.

(iii) Regarding a later sale of the shares any gain or profit due to the balance between the payment received and the acquisition-, incidental acquisition costs (including the acquisition costs of the options) is recognized for tax purposes.

(iv)The expiration of an option does not have any tax consequences. If the option is not executed the acquisition costs and the incidental acquisition costs are not deductible for income tax purposes. Thus they would be borne by the holder.

5. Yes.

6. No.

7. Premiums payments qualify as capital gains.

8. "Packages" such a structured financial instruments options are treated differently: If the embedded derivate displayed a higher, different or additional and different risks it is taxed separately. If the risk of the derivative and the underlying instrument are comparable only the income under the entire instrument is subject to taxation.

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F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. The premium is generally subject to CIT when it is received. 2. Taxes are not deducted from the respective income if the recipient is a credit or financial institution. Rather such institutions declare the taxable income in their corporate tax declarations. 3. No, the premium is taxed separately. 4. Yes, with regard to the writer the any gain or profit from the delivery of the shares is recognized for CIT purposes when the shares are delivered physically. However, generally 95% of any profit from the shares is tax exempted unless the seller is a credit or financial institution holding the participations to obtain short term profits. On the other hand, if the shares are not delivered physically but rather a cash settlement is made this cash settlement is irrelevant for income tax purposes. 5. Yes.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	Domestic financial institutions and domestic subsidiaries of foreign financial institutions are subject to unlimited tax liability in Germany. Branches of a non-domestic (financial) institution should qualify as a permanent establishment ("PE") in Germany. Therefore the branch/PE is subject to limited tax liability regarding the income allocated to the PE. The determination of the income follows German principles.

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H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	Not to our knowledge.

GREECE	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	[On 21/2/2011 a draft tax bill has been submitted before the Greek Parliament introducing several amendments on the Greek tax legislation. Reference to the proposed amendments is briefly made below. To be noted that the tax rules analysed below apply to traded financial instruments treated as compound products (equity swaps, call options, futures). In case of a bilateral contract (OTC) similar to the above (e.g. a bilateral agreement between two companies, giving to the one counterparty the right but not the robligation to buy the asset specified in the contract by a certain date for a certain price) the tax implications may depend on a careful examination of the terms of such particular contract.] ▪ There is a transaction duty on the sale of Greek listed shares at a rate of 0.15% on the gross sales proceeds. The transaction duty, which burdens the seller of the listed shares, is directly withheld upon each settlement of the transaction and paid by the Stock Exchange Depository SA to the competent tax authorities through the filing of a return within the first fifteen days of month following the one within which the transactions were effected (article 9, par. 2 of L. 2579/1998). The OTC transfers of Greek listed shares are also subject to the transfer duty of 0,15% on the sale price. The Athens Stock Exchange SA shall collect and attribute the transaction duty through the filing of a return to the competent tax office within the first fifteen days of the month following the one within which the OTC transactions are effected (article 21, par.1 of L.3697/2008). In such case, the connecting factor is the fact that the shares at stake are “Greek listed shares”. There is no available exemption from this duty (i.e. neither based on

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	local tax legislation nor based on a DTT). ▪ The same applies on the sale of foreign listed shares by Greek tax payers (i.e. Greek resident individuals, Greek enterprises and Greek branches of foreign entities). In such case, the connecting factor is the fact that seller is "a Greek taxpayer". In such case the seller should pay the duty due by the filing of a return within the first fifteen days of month following the one within which the transactions were effected (article 27, par.2 of L.2703/1999). ▪ Based on the draft tax bill, said duty shall be increased to 0,2% for sale of listed shares effected as of 1.4.2011 onwards. Moreover, according to the draft bill (not finalized yet) the transaction duty will be abolished for sale of listed shares initially acquired after 1.1.2012. Abolishment probably valid for shares listed either in Greece or abroad. Therefore, in case of sale of listed shares acquired prior to 1.1.2012 and sold after the 1.1.2012 the 0,2% duty will continue to apply. Example: Shares acquired in 2011 by A, sold by B in 2012 to C, and sold again to D in 2013. Based on draft provisions, no tax is due on the transaction between C and D in 2013.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the	Equity swaps fall under the definition of derivatives for taxation purposes.

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accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	▪ Capital gains deriving from transactions on **listed derivatives** either in the Athens Stock Exchange or in a Foreign Stock Exchange or other organized market are exempt from taxation, on condition that they are posted in a special reserve account, which can be used to offset future losses from listed derivatives. Said reserve account is subject to tax, based on the CIT applicable at that date, upon distribution or liquidation. There is thus a specific tax regime applicable to listed derivatives (e.g. swaps, options, futures, etc.). The only difference for Banks is the submission of the tax return in the 9th month from year end. Indeed, banks in particular are obliged to submit a respective tax return on the last day of the ninth month (i.e. September 30th) from the end of the fiscal year, in which the above special reserve was formed, so as to pay tax at the standard corporate income tax on the special reserve's balance. This means that, as regards the tax to be paid on the "special reserve", banks are worse off compared to other financial institutions (e.g. insurance companies) and non-financial institutions due to the fact that the tax is levied in September each year and not upon distribution or liquidation. Following the payment of the aforementioned tax, the remaining profits should be booked in a special account and can be distributed or capitalized free of tax. ▪ Greek tax law provides that gains arising from **non-listed derivatives** are subject to tax based on general provisions. These rules

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	are applicable similarly both to the FS and non-FS sector. Losses from non-listed derivatives are tax deductible on condition that the transaction has been effected for hedging purposes. This implies that payments cannot be considered separately. ▪ Further comments based on the example: the tax legislation does not specify the calculation of the profits/gains arising from non listed derivatives, as in the example. In any case it could be mentioned that unrealized profits are not usually recorded for tax purposes; in case an unrealized profit is recorded in the tax books, it is included in the company's taxable basis and is subject to tax a the standard CIT. If the proposed swap agreement can be viewed as a compound traded financial instrument, it could be supported that the netted amount of 300 could be regarded as a profit for B and a respective loss for A deriving from a non-listed derivative. In such case the profit would be taxable at the level of B (included in the taxable profits of the financial year). On the other hand, whether such loss would be recognized as tax deductible depends on whether it can be supported that the transaction has been effected for hedging purposes. The above comments apply to both FS and non FS companies.

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	Based on a draft bill the standard CIT is expected to be reduced to 20% for accounting periods starting as of 1/1/2011 onwards. The same CIT applies to FS and non FS companies. There is no differentiation between CIT and capital gains tax for the financial instruments under examination. The tax treatment of non-listed derivatives is not crystal clear in the law and each specific agreement should be analysed on its own merits to assess its tax treatment. ▪ Tax rules do not specify the calculation of the capital profits/gains arising from derivatives. Although based on a legislative provision introduced in 1997 (article 16a, par.12 of L.2459/1997), the Minister of Finance was authorized to regulate the calculation of the profits arising from derivatives, such Ministerial Decision has not been issued yet. ▪ The tax treatment of payments made to non-residents under an equity swap and on the sale of swap is not specified in the Greek tax legislation and related administrative jurisdiction. In the absence of specification of the tax treatment of the derivatives the characterization of the payments should be made on the basis of interpretation of the case at hand in conjunction with the provisions of the domestic tax legislation and the applicable DTT, if any. The exemption is based on the assumption that such payments shall/can be

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	characterized as "business profits" and not interest. One could indeed reasonably assume that such payments could fall under the “business profits” category and be exempt from WHT under a DTT; however, a more detailed analysis may be required before reaching a final conclusion. To be noted that the accounting treatment should not affect the above tax analysis.

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C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	Futures fall under the definition of derivatives for taxation purposes. Therefore, the analysis under equity swaps also applies to this case depending on whether the derivative is listed or not. The same comments as above apply. Moreover, mark-to-market, i.e. daily cash settlements, applies to futures listed in the Athens Derivatives Stock Exchange,

GREECE	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an roption seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	Options fall under the definition of derivatives for taxation purposes. Therefore, the above analysis applies also to this case depending on whether the derivative is listed or not.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a	For call options traded on the Athens Derivatives Stock Exchange, the premium is paid the day following the purchase of the call option and not as part of the stock acquisition price. Mark-to-market, i.e. daily cash settlements, does not apply to listed options. From a tax perspective, the option contract is treated as a compound instrument. Therefore, profits or losses arising from call options contacts shall be subject to tax as analysed above under equity swaps, depending on whether they are listed or not, without taking into account each

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call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xxxv) exercise of the options, (xxxvi) sale of the shares acquired through the option, (xxxvii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	underlying event (e.g. premium, disposal, exercise, expiration of the option). The sale of listed shares (irrespective of whether they have been acquired through the option or not) shall be subject to tax as follows: ▪ Gains arising from the subsequent sale of listed shares either in the Athens Stock Exchange or in a Foreign Stock Exchange or other organized market are exempt from taxation, on condition that they are posted in a special reserve account, which can be used to offset future losses from the sale of listed and non-listed shares. Said reserve account is subject to tax, based on the CIT applicable at that date, upon distribution or liquidation. ▪ In case where the shares have been acquired though an option derivative the share's listed price at the day of exercise of the option (and not the exercise price) is considered as acquisition price for the calculation of the capital gains. ▪ However, banks are obliged to submit a respective tax return on the last day of the ninth month (i.e. September 30th) from the end of the fiscal year, in which the above special reserve was formed, so as to pay tax at the standard corporate income tax on the special reserve's balance. Following the payment of the aforementioned tax, the remaining profits should be booked in a special account and can be distributed or capitalized free of tax. Based on the draft bill, gains from the sale of listed shares initially acquired as of 1/1/2012 shall be subject to tax based on the general provisions (CIT rate currently 24%, expected to fall to 20% as of 2011).

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F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	The same as under the above question, which means that in principle the writer should look at the transaction as a whole.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No

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H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No

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A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. No securities transaction tax is levied in Hungary. 2. -8. N/A
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	[General comments to be kept in mind in the rest of the questionnaire: Please note that in our experience, swaps, futures and options are mostly treated by companies for accounting purposes as non-hedge transactions. As a consequence, for the purposes of our below comments from Section D.2. to Section D.8., we assumed that the transactions are treated as non-hedge transactions. Also, we assumed that mark-to-market (which is optional) is not applied,

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1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	as it is usually the case in practice. Further, under Financial Sector, we meant banks and financial enterprises, as these types of companies are mostly involved in the transactions concerned.] 1. No special tax regime applies, the taxation follows the accounting treatment. 2. The general taxation rules apply. The CIT rate (10% up to HUF 500 million tax base, 19% above) is the same as for companies in the non-Financial Sector. It is noted, however, that accounting for provision (for expected losses from swap transactions i.e. if according to future trends the market price will significantly change) in the case of the Financial Sector may be necessary, but such provision is tax deductible. (Nevertheless, the Financial Sector may even be able to reduce its obligation to account for provision by pairing its non-hedge transactions with 'quasi' hedge transactions). In the case of the non-Financial Sector an accrued expense should be accounted for the expected loss. The expense accounted for is tax deductible. In summary, the tax regime for the financial and non-Financial Sector is the same in a sense that the expenses accounted for in both cases is tax deductible. 3.-4. Yes, taxed in the course of general corporate income taxation i.e. only the final gain (the difference between the payments received and made until the expiration) is taxable or the loss is tax-deductible. The final gain/loss will be realized at expiration, i.e. not on a cash-basis. After a contract has been concluded, both parties should account an off-balance-sheet receivable/liability in the relation to the futures part of the transaction. Any flows of payments before expiration will be accounted as

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	receivable / liability as a balance-sheet item. Finally, the flows of payments will be accounted as revenue / expense (and taxed) when the contract expires. If the swap is a non-hedge transaction and expired after the balance-sheet date but before the balance sheet preparation date, then the proportionate part (on the futures part) of the gain or loss should be accounted for as accrued income or expense. 5.-6- No WHT is levied on payments to non-residents upon the expiration or the sales of the equity swaps contract. 7. N/A
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how?	1. No special tax regime applies, the taxation follows the accounting treatment. When the futures contract expires, it is accounted for as a simple sales transaction. 2. The general taxation rules apply. It is noted, however, that accounting for provision (for expected losses) in the case of the Financial Sector may be necessary, but such provision is tax deductible. (Nevertheless, the Financial Sector may even be able to reduce its obligation to account for provision by pairing its non-hedge transactions with 'quasi' hedge transactions)). In the case of the non-Financial Sector an accrued expense should be accounted for the expected loss. The expense accounted for is tax deductible. 3. Yes, taxed in the course of general corporate income taxation, normally, when the futures expires, i.e. when the sales transaction is accounted for. If the transaction is a non-hedge transaction and expired after the balance-

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4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	sheet date but before the balance sheet preparation date, then the proportionate part of the gain or loss should be accounted for as accrued income or expense, and taxed respectively. 4. Optional. 5.-6. No WHT is levied on payments to non-residents upon the expiration or the sales of the futures contract. 7. N/A
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. No special tax regime applies; the taxation follows the accounting treatment. If the option buyer buys the asset at expiration, then a simple sales transaction will be accounted for. If the option buyer will not buy the asset at expiration, then it is treated as if no transaction took place at all. For details on paid and received premium please see Section E and F. 2. The general taxation rules apply. It is noted, however, that accounting for provision (for expected losses) in the case of the Financial Sector may be necessary, but such provision is tax deductible. (Nevertheless, the Financial Sector may even be able to reduce its obligation to account for provision by pairing its non-hedge transactions with 'quasi' hedge transactions). In the case of the non-Financial Sector an accrued expense should be accounted for the expected loss. The expense accounted for is tax deductible.

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E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xxxviii) exercise of the options, (xxxix) sale of the shares acquired through the option, (xl) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties?	1. General rule: premium should be accounted for when paid, however, should be included in the P&L (via accrued/deferred revenues or expenses) when the option is exercised. Scenarios (from a P&L perspective): a) If the option expires within the period (financial year) of writing: - deductible in that period. b) If the option expires after the balance sheet date, but before the balance sheet preparation date: - if the option is called, then time proportionate accounting applies; - if the option is not called, then the premium should be accounted for the previous financial year (whereas the option writer accounts for it in the prevailing financial year); c) If the option does not expire until the balance sheet preparation date: - deferred expenses. d) If the option expires without exercise of the option - premium is accounted as a deductible expense at expiration. It is noted that the premium may become part of the historical value of the asset purchased, which has an influence on the taxation of the premium paid. In general, the premium is deductible for corporate income tax purposes. 2. If the holder is an insurance company or a company in the non-Financial Sector the premium is accounted as a tax-deductible expense at the time of payment.

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8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	3. As we understand you are asking whether it is possible to account for the premium in the balance sheet as part of the book value of the received asset. If the asset is purchased for fixed assets, then it is obligatory to account for the premium as part of the book value. If the asset is purchased for inventory, then the holder can choose to account for the premium as part of the book value or not. The above applies to delivery transactions only. 4. After the option contract has been concluded, the holder will account an off-balance-sheet receivable. No taxation at this point. i) Disposal of the option As the transaction has been only accounted for off-balance-sheet items until expiration, to cancel it from the books will not have any effect on the profit. The profit or loss realised with respect to the premium paid and the premium received will be taxed in the course of the general corporate income taxation i.e. the disposal of the option is a taxable event, where the tax base is the difference between the premium received and paid. ii) When the option contract is exercised The holder will account for the asset purchased through the option and a decrease in its cash account. The transaction itself has no P&L effect i.e. it has no corporate income tax implications. iii) Sale of shares acquired through the option Taxed in the course of general corporate income taxation, unless it was a registered participation (minimum 30% held for at least 1 year and registered within 30 days upon acquisition) that is tax-exempt. iv) Expiration It is treated as if no transaction took place at all as it has been accounted for off-balance-sheet items.

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	5. May be optional (not allowed in all cases). 6. No WHT is levied on premiums. 7. N/A 8. It has to be determined on a case by case basis.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. When the contract expires, it will be accounted for as revenues taxable for corporate income tax purposes. General rule: premium should be accounted for (in the balance sheet, just as in the case of the option holder) when received, however, should be included in the P&L (via accrued/deferred revenues or expenses) when the option is exercised. Scenarios (from a P&L perspective): a) If the option expires within the period (financial year) of writing: - taxable in that period. b) If the option expires after the balance sheet date, but before the balance sheet preparation date: - if the option is called, then time proportionate accounting applies; - if the option is not called, then the premium should be taxable in the prevailing financial year; c) If the option does not expire until the balance sheet preparation date: - accrued income. d) If the option expires without exercise of the option - premium is accounted as a taxable revenue at expiration.

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	2. If the writer is an insurance company or a company in the non-Financial Sector, the premium is accounted as a taxable income at the time of payment. 3. As we understand you are asking whether it is possible to account for the premium as part of the strike price as revenues. Although both premium and the gain is accounted for as revenues, they are accounted separately (even maybe in separate revenue categories). In this sense there is no parallel regime in the hands of the holder and the writer. 4. When the option contract is exercised, the writer will account the book-value of the asset as expense and the transaction value of the asset as revenues. The difference is taxable for corporate income tax purposes. 5. May be optional (not allowed in all cases).
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No difference in taxation based on company form.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No.

IRELAND	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. Yes in certain instances Irish stamp duty can arise on the transfer of financial services instruments. 2. The transfer of a financial instrument which relates to the stocks or marketable securities of an Irish company (other than Irish regulated fund) or to Irish immovable property is liable to Irish stamp duty. The transfer of other financial instruments should be exempt from Irish stamp duty. 3. Section 2 and Schedule 1 of the Stamp Duties Consolidation Act 1999 (taxing provisions). Sections 88 and 90 of the Stamp Duties Consolidation Act 1999 (exemptions). 4. The higher of the consideration paid for the transfer or the market value of the financial instrument. 5. Mainly 1% for stocks or marketable securities but possibly up to 6%. No maximum amount due. The transfer of stocks or marketable securities of an Irish incorporated company is liable to Irish stamp duty at a rate of 1%. The transfer of an instrument which relates to the stocks or marketable securities of an Irish company (other than Irish regulated fund) or to Irish immovable property is liable to Irish stamp duty and the applicable rate will depend on the nature of the financial services instrument transferring. For example, where the financial services instrument is an option over Irish shares Irish stamp duty at a rate of 1% may apply, while if the instrument is a derivative contract a rate of 6% could potentially apply. The rate will very much be driven by the nature of the instrument transferring. The transfer of other financial instruments (not falling within 1. or 2. above) should

IRELAND	
	in general be exempt from Irish stamp duty. 6. Execution of assignment of an in scope financial services instrument 7. In scope if Irish property, if executed in Ireland or if relating to anything done or to be done in Ireland, subject to exemptions. 8. Self-assessment. The transferee is liable to pay the tax to the Irish Revenue Commissioners.

IRELAND	
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. Yes – general corporate tax regime applies. Taxable profit computed based on accounting profit. Corporate tax rate of 12.5% applies. 2. Non-Financial Sector liable to capital gains tax (CGT) at the rate of 25% on gains. The apparent disadvantage (of non FS in comparison to FS players, due to a difference in tax rates applicable) is due to the "taxhead" under which the transaction falls. If the taxhead is CGT, then the rate is 25%. If the swap relates to a trading transaction (as opposed to an investment), trading treatment should apply and subject to corporation tax at 12.5%. 3. Yes, as trading receipt – based on accounting treatment. 4. Yes, as trade expense – based on accounting treatment. 5. No 6. No 7. The nature of underlying asset determines the position. In any event, there is no WHT under Irish domestic law.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is	1. The general tax regime applies – treated as trading receipt/payment in the case of financial companies. Taxable profit computed based on accounting profit. Corporate

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relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	tax rate of 12.5% applies. 2. Non-Financial Sector liable to CGT at the rate of 25% on gains. However, where trading income treatment is not appropriate, if for example the future hedges a capital asset or liability, the derivative and the appropriate treatment will generally be CGT. In this case profits will be taxed on realisation. 3. Yes, as trading receipt/expense – based on accounting treatment. For non- trading transactions (if the transaction is carried out in the course of a trade, the trading rules must apply (i.e. 12.5% tax in the case of a body corporate). If the transaction is seen as a capital transaction then the CGT rate applies), gains/losses are subject to CGT at the rate of 25%. Capital losses are deductible against gains for this purpose. The date of disposal is by reference to date of contract. Note: 'Trade' is defined by the Irish tax legislation as including 'every trade, manufacture, adventure or concern in the nature of trade'. As normally understood, trading means the carrying on of business or the engaging in activities on a regular or habitual basis and normally with the view to realising a profit. Activities may however be carried on, even resulting in profits or losses, which fall short of being regarded as a trade and which will therefore not be charged to tax as trading income at a rate of 12.5%. The gains or losses may be capital in nature and therefore subject to capital gains tax treatment (and subject to capital gains tax at a rate of 25%). 4. Yes, generally applied for financial companies where used for accounting purposes. For non-financial companies, taxation generally only arises when there is a disposal.

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	Where not arm's length, mark to market is imposed for tax. Where the transaction is considered a capital transaction, the actual basis is applied i.e. gains crystallise on disposal. Where the transaction is not considered a capital transaction, the tax treatment tends to follow the accounting treatment. The tax treatment follows the nature of the asset being held (i.e. trading, passive or capital). It is difficult to say that there is discrimination against the non-Financial Sector given that the determination of trading/ passive/ capital nature of income applies to all companies operating in Ireland. 5. No. 6. No. 7. As per underlying asset. In any event there is no WHT under Irish domestic law.

IRELAND	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. General tax regime applies for Financial Sector i.e. taxable profit is based on accounting treatment 2. Capital gains tax regime (25%) applies to gains in case of non- Financial Sector

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E. Corporate income tax treatment of Call options on stocks in the hands of the holders

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This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xli) exercise of the options, (xlii) sale of the shares acquired through the option, (xliii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	1. Financial Sector – the premium is expensed as per accounts Non-financial – The premium is part of asset cost for CGT purposes if the option is exercised. Allowable loss arises on abandonment only if the option is a traded option, a quoted option or an option to acquire assets for the person's trade. 2. See reply at 1. above 3. Yes for non- financial companies (CGT). For financial companies, the premium is expensed as per the accounts. 4. (i) Financial companies– proceeds treated as a trade receipt. Gain taxed based on the accounts at 12.5% tax rate. Non-financial companies – gains liable to CGT at 25%. (ii) Financial companies – premium will have already been expensed in accounts); Non financial companies – premium treated as part of asset cost (iii) Financial companies – Treated as trade receipt (taxable at 12.5%) (most cases); For non-financial companies - gain on sale subject to CGT. (iv) See reply to 1. above 5. Yes for financial companies where applied in accounts. 6. No 7. &8 As per underlying asset. In any event there is no WHT under Irish domestic law.

IRELAND	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. Yes – For financial companies it is treated as a trading receipt taxable at 12.5%; For non-financial companies it is liable to CGT at 25%. Under the CGT rules, the vendor is treated as selling the asset for the total of the amount received for the grant of the option itself, plus the consideration receivable under the option for the actual sale of the asset - the option being regarded as part of the overall transaction. In circumstances where the option is not exercised, the option stands alone as a separate asset for CGT purposes. Options fit within the definition of a derivative under IAS 39 (FRS 26), which requires the option to be accounted for on the company's respective balance sheet with any fair value adjustments put through the P&L. The Irish legislation charges unrealised gains or losses on derivatives included in the P&L to tax under at a rate of 12.5% when considered trading in nature. On this basis, the taxation of any premium received should follow the accounting treatment of same. An option that is treated as capital in nature will be subject to CGT treatment. 2. As per 1. above. 3. For financial company, the accounting treatment (which depends on the accounting standards applicable - most likely "mark to market") will be followed. Option consideration (including the premium) is treated as part of the sale consideration in the hands of the grantor (=writer) (for non-financial company).

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	As mentioned above, the Irish legislation charges unrealised gains or losses on derivatives included in the P&L to tax at a rate of 12.5% when considered trading in nature. In the example, the premium of €10 forms part of the gain on shares of €30. 4. See 3. above. For non-financial company, grantor charged to CGT by reference to the asset price plus premium (i.e. total sale consideration). For financial companies, gain is taxable as per accounting treatment. 5. For financial companies mark to market will apply if applied in the accounts.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No.

ITALY	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	The Italian Securities Transfer Tax ("Tassa sui contratti di borsa") has been repealed with reference to the contracts signed from December 31st 2007 onwards. The stamp duty ("imposta di bollo") could apply to specific financial transaction provided that the relating contract is concluded in Italy. In particular, a flat stamp duty of 14,62 Euro could apply on each financial agreement.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain	The corporate income tax (IRES) is applied at the rate of 27,5% for all companies (both Financial Sector and other sectors). Article 112 of the Italian Consolidated Income Tax Act provides with the tax regime applicable for Corporate Income Tax (IRES) purposes to financial derivatives. In general, the tax regime applicable to financial derivatives depends on:

period of time.

1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)?

2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?

3. Are the flows of payments received taxed, if yes, when and how?

4. Are the flows of payments made tax deductible, if yes, when and how?

5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax?

6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax?

7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?

- the specific accounting principles applied by the investor for the purposes of drawing up its financial statement (Italian GAAP or IAS/IFRS); and

- the qualification of the financial derivatives as "hedging" or "not hedging/trading".

For entities applying the IAS/IFRS are valid for IRES purposes the qualification, classification and time allocation criteria provided for by the IAS/IFRS.

In Italy the following Entities must apply IAS/IFRS:

- companies issuing securities admitted to trading in regulated markets;

- companies issuing financial instruments widely distributed among the public;

- banks;

- holdings of banking groups;

- assets management companies;

- other regulated financial companies;

- electronic money institutions.

Insurance companies are not requested to apply IAS/IFRS (apart specific exceptions). Other companies – individuated by the law in specific situations – may apply IAS/IFRS on a voluntary basis (quite unusually in the market practice).

Generally speaking thus, financial entities (except insurance companies) apply IAS/IFRS, whilst commercial companies apply IAS/IFRS only if they

	issue financial instruments to the public. For entities applying the Italian GAAP, as a general rule, with reference to the "trading derivatives" are relevant for tax purposes the positive or negative items of income arising from the year-end accounting evaluation. However, in case of negative items of income, the year-end evaluation for tax purposes must quantified following specific guidelines provided for by the tax rule (for example for derivatives listed in regulated markets the year-end evaluation must be equal to the official value fixed in the last listing day of the fiscal period). On the other hand, the tax regime applicable to the "hedging derivatives" follows the tax regime applicable to positive/negative items of income arising from the evaluation/realization of the underlying instruments. In addition to IRES there is also a Regional Tax on Productive Activities purpose (IRAP). For Regional Tax on Productive Activities purpose (IRAP) the items of income arising from financial derivatives in principle should be relevant for financial entities, whilst they should not be relevant for not financial entities. For financial entities, generally, the IRAP rate is 4,82% (or 4,97% in some regions), while for the companies of the other sectors this rate varies from 3,9% to 4,97%. depending on the regions. As far as WHT treatment: the payments to a non-resident holder of a financial derivative should not be subject to domestic WHT.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is	Please, make reference to the general comments specified in relation to the

relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	equity swaps. 2. Regardless timing and method of recognition which depend on the accounting principles applied by each type of company, gains and losses relating to financial futures are relevant for CIT purposes (IRES tax rate is 27,5%) for both financial companies and companies pertaining to other sectors. On the other side, for the Regional on Productive Activities Tax purposes (Regional tax rate: from 3,9% to 4,97%), gains and losses are, in principle, relevant only for the financial entities.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although	1. Please, make reference to the general comments specified in relation to the equity swaps. 2. Please, make reference to our previous comments specified in relation to the financial

reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	futures about the differences between financial companies and other companies.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?	1. Please, make reference to the general comments specified in relation to the equity swaps. 2. There are differences relating to timing and method of recognition due to different accounting principles. Apart this, the ordinary IRES rules apply to both financial entities and non financial entities. In principle IRAP on these items applies only for financial entities. The accounting and tax treatment may change depending on the settlement method (i.e. physical settlement or cash settlement). In fact, in case of cash settlement, cost and revenues relating to the call options are fully relevant for IRES purposes. On the other side, in case of physical settlement, the premium

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2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xliv) exercise of the options, (xlv) sale of the shares acquired through the option, (xlvi) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	cost could be added to the cost of the underlying shares depending on the accounting rules applicable to each type of company. 3. When, as a result of the call option, the holder buys the stock, in principle the premium can be view as an ancillary cost of the acquisition (this is always verified for call options held by individuals, while if the holder is a company a preliminary check of the accounting principle applicable to the holder must be performed). 4. (i) Gains and losses deriving from the disposal of options are relevant for IRES purposes. For financial entities they are relevant also for IRAP purposes. (ii) In principle the cost paid for the option is added to the price paid for the stock. (iii) Capital gains / Losses shall be calculated starting from the tax value of the shares (which may include the cost of the premium). For shares other than those included in the held for trading portfolio (for IAS adopters) and for shares posted among fixed assets (for companies which apply local GAAP), provided that certain conditions are satisfied, the participation exemption regime (PEX) implies: - taxation on 5% of capital gains amounts; - losses are not tax deductible. (iv) The premium cost is relevant for tax purposes.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would	Please, make reference to the general comments specified in relation to the equity swaps. 1. In principle, the premium received by the writer falls entirely in the taxable base. Timing may depend on the accounting principles applied by the writer. 2. Difference may exist on timing. Nevertheless, the premium is always taxed for IRES

ITALY	
have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	purposes, while it is relevant for IRAP purposes only for financial entities.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No, the provisions applicable to the Italian banks are the same as those applicable to subsidiaries and branches of non-domestic banks
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	In principle, actual practices are compliant with the legal provisions.

LATVIA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. No. 2. .-8. N/A
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	1. General tax rules apply. The applicable standard CIT rate is 15%, for all sectors. 2. No difference 3. Taxed as part of a Latvian tax payer's annual general taxable profits and CIT treatment follows accounting treatment, i.e. any unrealised gains/ losses are non-taxable/ tax non-deductible and realised gains/ losses are taxable/ tax deductible. There are no specific rules in respect of equity swaps in Latvian corporate income tax law and Latvian taxpayers (banks or other sectors) do not break

LATVIA	
1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	down, for tax purposes, the flows of payments received into components based on their economic substance. 4. See answer to (3). There are no specific rules in respect of equity swaps in Latvian corporate income tax law and Latvian tax payers (banks or other sectors) do not break down, for tax purposes, the flows of payments made into components based on their economic substance. 5. No WHT on payments to non-residents under the swap. 6. No WHT on payments to non-residents on sale of swap. 7. There is no guidance in respect of equity swaps in Latvian tax law. Latvian tax payers (banks or other sectors) do not break down, for tax purposes, the flows of payments connected with equity swaps into components based on their economic substance.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. General tax regime applies 2. No difference 3. Taxed as part of a tax payer's annual general taxable profits and CIT treatment follows accounting treatment, i.e. any unrealised gains/ losses are non-taxable/ tax non-deductible and realised gains/ losses are taxable/ tax deductible 4. See point 3 above 5. No WHT on payments to non-residents upon the expiration of the futures 6. No WHT on payments to non-residents on the sale of futures 7. N/A

LATVIA	
3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. General tax regime applies 2. No difference

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E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (xlvii) disposal of the options, (xlviii) exercise of the options, (xlix) sale of the shares acquired through the option, (l) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties?	1. No specific guidance in the law, therefore, tax treatment follows accounting treatment. 2. No difference. 3. No specific guidance in the law, therefore, tax treatment follows accounting treatment, i.e. if expensed to income statement when paid – deductible when paid; if recorded as part of the stock acquisition price – deductibility depends on the tax treatment of the stock (see point 4 below). Usually, premiums paid are recorded in the balance sheet and amortised to income statement over a period of time. 4. Realised gains or losses are taxable/ tax deductible as part of annual general taxable profits on all the following events: (i) disposal of the options, (ii) exercise of the options, (iv) expiration of option (without exercise or disposal), (iii) Sale of the shares acquired through the option – rules differ for different types of shares: a) Shares publicly quoted in EU and EEA - realised gains/ losses on shares publicly quoted in EU/ EEA are non-taxable/ tax non-deductible. b) All other shares – total annual net gains realised on sale of the shares acquired through the options are taxed in the respective tax year. Total annual net losses realised on sale of the shares acquired through the options are non-deductible in the respective tax year, but may be carried forward for 8 years and set against future total net gains from sale of shares.

LATVIA	
8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	5. Any gain/ loss arising from application of mark-to-market for accounting purposes is regarded as unrealised gain/ loss for tax purposes. Unrealised gains/ losses are non-taxable/ tax non-deductible. 6. No WHT on premium to non-residents. 7. N/A 8. No guidance in tax law.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. No specific guidance in the law, therefore, tax treatment follows accounting treatment. Usually, premiums received are recorded in the balance sheet and amortised to income statement over a period of time. 2. No difference. 3. No specific guidance in the law, therefore, tax treatment follows accounting treatment. 4. Gains or losses realised upon exercise of the options are taxable/ tax deductible as part of annual general taxable profits. 5. Any gain/ loss arising from application of mark-to-market for accounting purposes is regarded as unrealised gain/ loss for tax purposes. Unrealised gains/ losses are non-taxable/ tax non-deductible.

LATVIA	
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	There are no specific rules in respect of financial instruments in Latvian tax law, nor have Latvian tax authorities issued any guidance. Usually, in practice, all payments under equity swaps, financial futures and call options on stocks contracts are treated as capital gains for CIT and WHT purposes.

LITHUANIA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. No 2. N/A 3. N/A 4. N/A 5. N/A 6. N/A 7. N/A 8. N/A
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain	1. According to Part 13 Article 2 of the Law on Corporate Income Tax (CIT) a derivative is a financial instrument (a future transaction, an agreed in advance transaction) which: (I) value alters depending on a price of the goods, securities, currency rate or similar variable, (II) does not require any or only marginal initial investment compared to other types of transactions, (III) settlement (payment) should be performed in the future.

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period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	*Unrealised gains (income)/losses (expenses).* Specific tax rules apply for revaluation of derivatives. The gains or losses recognised from revaluation of derivatives held for trading (speculative) purposes are exempt and non-deductible respectively, whereas gains recognised from revaluation of derivatives held for hedging (risk insurance) purposes are taxable and losses are deductible. Example. If the derivative is held for trading purposes, for B unrealised gain of 200 is non-taxable income, for A unrealised loss of 200 is non-deductible expenses. *Realised gains (income)/losses (expenses).* Taxation of gains/losses from realised transactions (i.e. recognised upon the maturity of a contract) is not explicitly described in the Law on CIT and related commentary. Generally, they should be recognised based on an accrual principle and be subject to general tax regime: gains – taxable; losses – deductible, provided that they are related to earning taxable income and deriving economic benefits of a company. Example. If the derivative is held for trading purposes, for B realised gain of 300 is taxable income, for A realised loss of 300 is deductible expenses. Taxation moment – earlier of 1) maturity of a contract or 2) actual payment. 2. No. 3. Yes, upon the payment provided that there was no income recognised upon the maturity of a contract. 4. Yes, upon the payment provided that there was no costs (loss) recognised upon the maturity of a contract.. 5. No. According to Part 4 Article 4 on the Law on CIT, payments under a derivative

	contract are not included in the list of payments which are subject to WHT. 6. No According to Part 4 Article 4 on the Law on CIT, payments under a derivative contract are not included in the list of payments which are subject to WHT. 7. Not applicable. According to Part 4 Article 4 on the Law on CIT, payments under a derivative contract are not included in the list of payments which are subject to WHT.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the	1. See the answer to the first question under B. above. 2. No 3. See the answer to the first question under B. above. 4. No 5. No 6. No 7. See the answer to the seventh question under B. above.

connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. See the answer to the first question under B. above. 2. No
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover	1. Generally, deductibility of the premium paid for call options are not explicitly commented in the Lithuanian Law on CIT. However, following general provisions of

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the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (li) exercise of the options, (lii) sale of the shares acquired through the option, (liii)expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	the Law on CIT, the premium paid should be deductible upon its acquisition provided that it is related to earning of taxable income and receiving economic benefits by a company. 2. No 3. Premium paid may be included in the stock acquisition price, although, it is not explicitly described in the Lithuanian Law on CIT. 4. Recognised gains are taxable at standard CIT rate of 15%. Recognised losses can be carried forward for 5 years and covered against the profits received from the same type of activities (sale of securities and/or derivatives). Upon exercise of the options, gains or losses related to the difference between an exercise price and a market price are not recognised for tax purposes. Purchase of the stocks is not the subject to taxation and any subsequent adjustments to the stock price are not considered for tax purposes unless stocks are sold. *Local participation exemption rule.* According to Paragraph 15 Article 12 of the Law on CIT, when acquired shares are of a company registered or otherwise organised in a Member State of the European Economic Area or in the State with which Lithuania has a DDT, and they constitute for more than 25% of all shares and are kept for at least 2 years, gains are exempted and losses cannot be carried forward, but can be offset in the same year against the profits of the same nature (sale of securities and/or sales of derivatives). If requirement for participation are not met, gains recognised on sale of shares are taxable and related losses can be carry forward for five years and can be covered

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	against the profits of the same nature (sale of securities and/or sales of derivatives). We understand that the losses (expenses) will include only the premium paid. For tax treatment please see the answer to the first question under E. above. 5. No 6. No 7. See the answer to the seventh question under B. above. 8. Not explicitly described in the Law on CIT, but following substance over form principle established Article 10 of the Law on Tax Administration gains (income) and/or losses (expenses) related to options should be separated and taxed accordingly. For tax treatment please see the answer to the first question under B. above.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non	1. Generally, taxation of the premium received for call options are not explicitly commented in the Lithuanian Law on CIT. However, following general provisions of the Law on CIT the premium should be recognised based on an accrual principle, i.e. through the life time of the option, and taxed with 15% CIT. 2. No 3. No 4. See the answer to the question under E. above (Part 4, Paragraph iii). 5. No

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Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No

LUXEMBOURG	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. There are no securities transaction taxes in Luxembourg. However, an *ad valorem* or fixed duty may be applied in case of voluntary registration (depending on the type of instruments/transaction). 2. – 8. N/A.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain	[General comments to be kept in mind in the rest of the questionnaire: Our analysis is based on the Luxembourg Generally Accepted Accounting Principles and may differ should the IFRS be followed. The notion of beneficial/economic ownership should be taken into account and analyzed on a case-by-case basis (i.e. depending on the features of the financial instrument) as it has an impact on the determination of the person

period of time.

1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)?

2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?

3. Are the flows of payments received taxed, if yes, when and how?

4. Are the flows of payments made tax deductible, if yes, when and how?

5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax?

6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax?

7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?

who is entitled to the income (or loss) and who bears the risk.]

1. There are no specific tax rules regarding the taxation of swaps. The general tax principles are applicable. As a result, their tax treatment follows in principle their accounting treatment unless otherwise provided for by the Luxembourg tax legislation (article 40 of the Luxembourg Income Tax Law, "LITL").

2. There is no main difference in the tax treatment. However, some differences may arise from the fact that the overriding accounting principle for regulated entities is the "fair picture" principle. The application of such principle may lead to differences in the timing of recognition of income and loss (i.e. deduction over the length of the transaction v. one-shot deduction).

As, according to the provisions of article 23 LITL, a taxpayer cannot book its assets for a value higher than its historical cost (however debts can be valued at the operating value), in certain circumstances, the annual increase in value of an asset which is booked accounting wise may be neutralized tax wise (no taxation during the length of the transaction) in order to recognize the gain only at the end of the transaction

3 + 4. As mentioned before, the tax treatment of swaps should follow the accounting treatment (unless otherwise provided for by the Luxembourg tax legislation). As a result, any income/gain is in principle taxable at 28.80% (applicable rate for Luxembourg city) and any expense/loss is in principle tax deductible.

However, in case such income/gain is assimilated, for tax purposes, to an income from a qualifying participation (due to substance over form) it could be tax exempt. Besides, any expense in connection with tax exempt income is in principle non tax deductible.

Regarding the timing issue, two principles are particularly important, i.e. the

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	caution and the matching principle. The caution principle prevents from the recognition of unrealized gain whereas it encourages the recognition of unrealized losses. The matching principle provides for the recognition of income and expenses in the year to which they relate (whenever the payment actually takes place). 5. As a preliminary remark, the qualification of the payments made under swap agreement (and derivative as well) should be analyzed on a case-by-case basis. Normally, such payments should be seen as *sui generis* payment except if they fall under specific provision of a relevant double tax treaty. For instance, due to substance over form (and depending on the analysis of the legal agreements), payments under swap agreement may potentially be reclassified as dividend in very specific circumstances. 6. Luxembourg does not levy any WHT on interest/premium payments except if: (i) They derived from profit participating securities (e.g. profit sharing bonds), (ii) They are within the scope of the EU Savings Directive, (iii) They are requalified as dividend payments (15% WHT on gross payments subject to potential exemptions), for example according to thin-capitalization rules. 7. There is no clear rule regarding the qualification of swap payments under double tax treaties. It will mainly depend on the swap agreement (to be analyzed on a case-by-case basis) and it may also depend on the nature of the underlying in certain circumstances.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although	For all these questions, please refer to our comments on equity swaps. Our

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reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	comments on article 23 LITL are particularly relevant regarding the mark-to-market question.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not	Please refer to our previous comments on swaps. For call options, specific attention should be paid to the determination of the beneficial/economic

cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	owner. Generally, the economic owner is deemed to be the legal owner. However, in certain specific circumstances, the economic owner could be different and he should normally prevail for tax purposes (§11 StampG). This may lead to disregard the option and directly consider that the option buyer already holds the underlying assets. Some guidance has been provided in a recent case law regarding options on shares (Cour Administrative n°25443C, 16 June 2009).
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or	For the purposes of this section, we have assumed that the option does not lead to the qualification of the call option holder as economic owner of the underlying stocks. The main principles described above in our comments (i.e. tax follows accounting as a principle …) are also applicable to call options on stocks in the hands of the holders. 1. Based on the accounting treatment, the premium paid should generally not be tax deductible as the premium should be booked as an asset. At maturity, it will only be tax deductible upon expiration as otherwise it will be taken into account for the stock

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upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (liv) exercise of the options, (lv) sale of the shares acquired through the option, (lvi) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	acquisition price. 2. See our above comments. 3. Yes (see above). 4. (i)The gain/loss in case of disposal of option will be taxable/tax deductible. (ii)In case of exercise of the option, the premium paid will be added to the acquisition price of the stocks. This will not be a taxable event. (iii)The gain/loss realized in case of sale of the shares will be taxable/tax deductible. Such gain may be tax exempt based on the participation exemption regime in very specific circumstances. (iv)As mentioned above, the loss in case of expiration of option will be tax deductible. 5. See our above comments on article 23 LITL for swap transactions. 6. See our above comments on swap transactions. 7. See our above comments on swap transactions. 6+7: Regarding any potential WHT on call options payments and their qualification under double tax treaties, we referred to our comments on swap agreements in question B. 5,6,7. In principle, there is no WHT on interest/premiums in Luxembourg. However, any transaction should be carefully analyzed, together with the legal agreement, as, due to substance over form, options could sometimes be disregarded, the option buyer being considered as holding already the underlying shares (and WHT could apply on dividend payments). 8. Generally, options granted into a packaged product, such as equity linked note, are not taken into account on a standalone basis for accounting and tax purposes. The tax treatment applied will generally be the one of the main product (here the note). However, it will depend on the specific legal agreement and should be analyzed on a case-by-case

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	basis.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	For the purposes of this section, we have assumed that the option does not lead to the qualification of the call option holder as economic owner of the underlying stocks. The main principles described before in our comments (i.e. tax follows accounting as a principle …) are also applicable to call options on stocks in the hands of the writers. 1. Based on the accounting treatment, the premium received should generally not be included in the P&L until its maturity. At maturity, it will be taxable upon expiration. Otherwise, it will be taken into account for the stock delivery price and could be taxable as a capital gain /or exempt if all the conditions for the participation exemption regime are met). 2. See our above comments. 3. Yes (see our above comments). 4. Gains/losses upon exercise are taxable/tax deductible. However, depending on several conditions, gains could be tax exempt if the requirements of the participation exemption regime are met. 5. See our above comments.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No.

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H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No. Practices are based on provisions of the domestic tax legislation and relevant case law.

MALTA

A. Securities transaction taxes

Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question.

1. Are there securities transactions taxes on transfers of financial instruments?
2. What securities are in scope and which are exempt?
3. What are the tax provisions (reference to applicable tax section)?
4. Tax base?
5. Tax rate? Is there a maximum amount of tax due?
6. Tax event?
7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)?
8. Who is liable for levying the tax? Who is liable to support the tax?

1. No.

2. Although there is no specific tax on transfers of securities, such transfers may still be subject to Maltese income tax in terms of the general tax provisions. One has to distinguish between securities held as capital assets and securities held for trading purposes. In the case of capital assets, tax on capital gains may be due if the particular security falls within the purport of the tax on capital gains provisions - not all securities would fall within such capital gains provisions. Furthermore, certain exemptions from tax on capital gains may apply. Where the securities are held for trading purposes, then the trading gain on the transfer of securities should in general be subject to Maltese income tax.

3. Charging provisions:

   - Transfers of securities held as capital assets : Article 5 of the Income Tax Act;

   - Transfers of securities held for trading purposes : Article 4 of the Income Tax Act.

4. Subject to the applicable detailed statutory provisions, the tax base should in general be the cost of acquisition paid for the security.

5. In the case of companies, the normal corporate tax rate of 35% should apply on a taxable gain arising on the transfer of a security. Where the transferor is an individual, the gain on the transfer of a security should be subject to tax in accordance with the marginal tax rate of the individual (going up from 0 to 35%). There is no capping in the tax payable.

6. The tax event on a chargeable transfer occurs upon the transfer of the security. Provisional tax should in general be payable upon the transfer of the security with any balance in the actual tax liability being payable by the transferor upon the submission of the relevant tax return.

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	7. In terms of Maltese tax law (but this is subject to any double taxation treaty provisions which would supersede the domestic provisions), a Maltese company is subject to tax on its worldwide income/ gains. A foreign company which is resident in Malta, would be subject to tax on any chargeable income/ capital gains arising in Malta and on any foreign income (but excluding foreign capital gains) which is received in/ remitted to Malta. In the case of an individual, if the individual is both ordinarily resident and domiciled in Malta then he/ she is taxable on his/her worldwide chargeable income/ capital gains. An individual who is not ordinarily resident or not domiciled in Malta is taxable only on income arising in Malta and on any foreign income received in/ remitted to Malta, so however that if the particular individual is not ordinarily resident in Malta, he/ she would be taxable in Malta only on income arising in Malta. There are no detailed specific rules in Maltese tax law as to the determination of the locality where the income/ gain arises and this may depend on a number of factors and are subject to the particular circumstances of each case. 8. The Maltese income tax on the transfer of a chargeable security should be due and payable by the transferor.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap	1. (& 3 & 4) There are no specific tax rules under Maltese law regulating swap transactions. The accounting treatment (Malta follows IFRS) may have an impact on the Maltese income tax treatment but it may not always necessarily be the case that the tax treatment would follow the accounting treatment – see below re advisability of confirmation of the tax position with the Maltese Revenue. 2. Given that there are no specific tax rules in Malta dealing with swap transactions, this question is not relevant. 3. In view of the fact that there are no specific tax rules in Maltese income tax law regulating such transactions nor Revenue guidelines on the matter, it would be strongly advisable that the tax position would be clarified in writing with the Maltese

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transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	Revenue. Indeed this is the normal practice here in Malta especially in such cases where there are no specific tax rules on the subject. The Maltese income tax treatment will primarily depend on the characterisation of the income flows for Maltese tax purposes. If the flows were to be classified as dividends, there should be no WHT on dividends paid to non-residents as long as such non-residents are not owned and controlled by, directly or indirectly, nor act on behalf of an individual who is ordinarily resident and domiciled in Malta. 4. Under Maltese tax law, in general an expense is tax-deductible if it is wholly and exclusively incurred in the production of the income. Hence the expense must be incurred in producing the income for the expense to be tax deductible. As in point 3, given the absence of tax rules and Revenue Guidelines on such transactions, it is strongly advisable that the tax deductibility point would also be confirmed in writing with the Maltese Revenue. 5. Refer to our comments in point 3 of this part. 6. One would need to determine whether the sale of a swap is a taxable transaction for Maltese tax purposes. If it is determined that such a sale is taxable in Malta, then one would also need to consider whether any specific tax exemption under Maltese tax law would apply in the particular circumstances, e.g. there are exemptions from Maltese WHT on gains arising to non-Maltese-residents from the transfers of certain shares / securities. Again it is strongly advisable that such considerations are clarified in writing with the Maltese Revenue. 7. We are not aware that the Maltese Revenue have taken a particular stand or approach in classifying such payments for double taxation treaty purposes. In general, we are also not aware that Malta's treaties provide for any particular treatment for such payments (although naturally we have not reviewed all of Malta's treaties currently in force to establish this point).

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C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. There are no specific tax rules under Maltese law regulating financial futures. The accounting treatment (Malta follows IFRS) may have an impact on the Maltese income tax treatment but it may not always necessarily be the case that the tax treatment would follow the accounting treatment – see below re advisability of confirmation of the tax position with the Maltese Revenue. 2. Given that there are no tax rules in Malta on financial futures, this question is not relevant. 3. In principle, if any gains or losses arise from the futures then arguably they should be taxable/ tax deductible in that we are not aware of any specific tax exemption under Maltese tax law in this respect. If it is confirmed that such gains are subject to Maltese income tax, then the normal corporate tax rate of 35% should apply. However given that there are no tax rules in Malta regulating such transactions nor Revenue Guidelines on the matter, it would be strongly advisable that the tax position would be confirmed in writing with the Maltese Revenue. As outlined above, this is the normal practice here in Malta especially in such cases where there are no specific tax rules governing these transactions. 4. Given that a financial future is a derivative instrument, in terms of IFRS it must be marked to market. 5. One would need to determine whether the payment to non-residents upon the expiration of the future is a taxable transaction for Maltese tax purposes. If it is determined that such a payment is taxable in Malta, then one would also need to consider whether there could be any tax exemption under Maltese tax law which could apply in the particular circumstances. Again given the absence of any specific rules or Revenue guidelines on the matter, it is strongly advisable that such considerations are clarified in writing with the Maltese Revenue.

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	6. Refer to our comments in point 5 of this part. 7. We are not aware that the Maltese Revenue have taken a particular stand or approach in classifying such payments for double taxation treaty purposes. In general, we are also not aware that Malta's treaties provide for any particular treatment for such payments (although naturally we have not reviewed all of Malta's treaties currently in force to establish this point).
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. There are no specific tax rules under Maltese law regulating call options on stocks (there are special tax rules in Malta applicable to share options granted by a company to its employees or to the employees of an associated company; however we understand that these rules are not relevant in the context of this question). The accounting treatment (Malta follows IFRS) may have an impact on the Maltese income tax treatment but it may not always necessarily be the case that the tax treatment would follow the accounting treatment. Hence, given that there are no tax rules in Malta regulating such transactions nor Revenue Guidelines on the matter, it would be strongly advisable that the tax position would be confirmed in writing with the Maltese Revenue. As outlined above, this is the normal practice here in Malta especially in such cases where there are no specific tax rules governing these transactions. 2. Given that there are no tax rules in Malta on call options on stocks, this question is not relevant.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on	1. As outlined in the previous section, there are no specific tax rules under Maltese law

any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer.

1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?

2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector?

3. Is the premium paid part of the stock acquisition price?

4. Please describe the tax treatment of the gains or losses realised at the following events:

   (i) disposal of the options,

   (lvii) exercise of the options,

   (lviii) sale of the shares acquired through the option,

   (lix) expiration of option (without exercise or disposal)

5. Is mark-to-market applied?

6. Is there a WHT on premium to non-residents?

7. How are the premium payments classified under the double tax treaties?

8. How are options treated when they are part of a packaged product (e.g. equity linked note)?

regulating call options on stocks. An expense is deductible for Maltese tax purposes if it is wholly and exclusively incurred in the production of the income. Hence the expense must be incurred in producing the income for the expense to be tax deductible.

Given the absence of tax rules and Revenue Guidelines on such transactions, it is strongly advisable that the tax deductibility point would be confirmed in writing with the Maltese Revenue.

2. Given that there are no tax rules in Malta on call options on stocks, this question is not relevant.

3. Given the absence of tax rules and Revenue Guidelines on this matter, this would need to be clarified in writing with the Maltese Revenue.

4. We assume that this question does not cover share options provided by a company to its employees. Refer to our comments in point 3 of this part.

5. Given that a call option on stocks is a derivative instrument, in terms of IFRS it must be marked to market.

6. One would need to determine whether the premium is chargeable to tax in Malta. If it is determined that such a premium is taxable in Malta, then one would also need to consider whether any specific tax exemption under Maltese tax law would apply in the particular circumstances, e.g. there is an exemption (subject to the satisfaction of certain conditions) from Maltese WHT on "any interest, discount, premium or royalties accruing to or derived by any person not resident in Malta". Again it is strongly advisable that such considerations are clarified in writing with the Maltese Revenue.

7. We are not aware that the Maltese Revenue have taken a particular stand or approach in classifying such payments for double taxation treaty purposes. In general, we are also not aware that Malta's treaties provide for any particular treatment for such

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	payments (although naturally we have not reviewed all of Malta's treaties currently in force to establish this point). 8. Refer to our comments in point 3 of this part.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. Given the absence of tax rules on this matter and also no Revenue Guidelines, one needs to determine whether such premium is taxable in Malta and, if in the affirmative, whether any specific tax exemption on the payment of premiums to non-residents may be applicable in the particular circumstances (refer to our comments in point 6 of the previous part). Again it is strongly advisable that such considerations are clarified in writing with the Maltese Revenue. 2. Given that there are no tax rules in Malta on call options on stocks, this question is not relevant. 3. Given the absence of tax rules and Revenue Guidelines on this matter, this would need to be clarified in writing with the Maltese Revenue. 4. We assume that this question does not cover share options provided by a company to its employees. Refer to our comments in point 3 of this part. 5. Given that a call option on stocks is a derivative instrument, in terms of IFRS it must be marked to market.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-	No.

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domestic (financial) institution?	
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	There are no Revenue Guidelines/ official practices on these matters and even Maltese tax law does not shed light in respect of most of the matters raised above.

THE NETHERLANDS	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. The Netherlands does not have securities transaction tax on specific type of financial transactions. Real estate transfer tax may be due in cases where the financial transaction would be considered a transfer of a Dutch real estate.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain	1. The general tax regime should apply. 2. There should be no difference in the tax treatment of swaps between financial and non-financial companies. 3. The flows of payments should in principle be subject to the regular corporate income tax of 25% (rate 2011). Under Dutch tax accounting principles, the accounting period to which income/costs should be allocated, should be determined in accordance with the matching

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period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	principle/accrual basis; i.e. expenses are recognized when incurred and income should be recognised when earned. Cash accounting is generally not acceptable under Dutch tax accounting principles. 4. The flows of payments should in principle be tax deductible. Under Dutch tax accounting principles, the accounting period to which income/costs should be allocated, should be determined in accordance with the matching principle/accrual basis; i.e. expenses are recognized when incurred and income should be recognised when earned. Cash accounting is generally not acceptable under Dutch tax accounting principles. In specific situations, Dutch anti-abuse rules such as with respect to interest payments may limit the tax deductibility of the payments. 5. No. 6. No. 7. Payments as mentioned in questions 5 and 6 will in principle be classified as general /other payments and should not be subject to Dutch WHT.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules	1. The general tax regime should apply on futures. 2. There should be no difference in the tax treatment between financial and non-financial companies. 3. Gains and losses on futures are in principle taxed /deductible. On the basis of the Dutch tax accounting principles, unrealised profits may be recognised upon realisation (i.e. unrealised profits may generally be deferred till realisation), whilst unrealised losses may be recognised immediately. 4. Under Dutch tax accounting principles, generally, assets are valued at cost price or

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applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	the lower market value. Valuation at mark-to-market is, however, also allowed under Dutch tax accounting principles. This rule applies to all Dutch taxpayers (and not only FS players). Under Dutch tax accounting principles, taxpayers may choose to value assets at cost price or mark-to-market. Note that he taxpayer should use a valuation system in a consistent manner, i.e. there must be a certain degree of continuity in the method used and may only be changed if this is in line with sound business practice. The market practice in this regard is generally the use of cost price or lower market value. 5. No. 6. No. 7. Payments as mentioned in questions 5 and 6 will in principle be classified as general/other payments and should not be subject to Dutch WHT.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price).	1. The general tax regime should apply on option contracts. 2. There should be no difference in the tax treatment between financial and non-financial companies.

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1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (lx) exercise of the options, (lxi) sale of the shares acquired through the option,	1. The premium paid is generally tax deductible. This may be different if the Dutch participation exemption would apply. In such a case the premium would be non-deductible. The participation exemption may apply on options that give right to acquire shares on which the participation exemption would apply (generally 5% or more shareholding) if the option is exercised. 2. There should be no difference in the tax treatment between financial and non-financial companies. 3. Based on Dutch case law with respect to the application of the Dutch participation exemption, a premium paid is considered part of the stock acquisition price in situations where the participation exemption would apply. It is not clear whether the case law also applies in situations where the participation would not apply. 4. Gains/losses realised should in principle: (i) be taxed/deductible (ii) be taxed/deductible

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(lxii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	(iii) be taxed/deductible (iv) be taxed/deductible (deductibility of the premium paid because of the non-exercise of the option). If the participation exemption would apply, the gains/losses may be exempt from Dutch taxation. Under Dutch tax accounting principles, generally, assets are valued at cost price or the lower market value. Valuation at mark-to-market is, however, also allowed under Dutch tax accounting principles. This rule applies to all Dutch taxpayers (and not only FS players). Under Dutch tax accounting principles, taxpayers may choose to value assets at cost price or mark-to-market. Note that he taxpayer should use a valuation system in a consistent manner, i.e. there must be a certain degree of continuity in the method used and may only be changed if this is in line with sound business practice. The market practice in this regard is generally the use of cost price or lower market value. 5. No. 6. Premium payments will in principle be classified as general/other payments not subject to Dutch WHT. 7. Similar as above. Note, however, that in specific situations the Netherlands may apply the substance over form principle.

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F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. Based on Dutch tax accounting principles, profits should be recognised when earned. With respect to option premiums received, this would generally be upon expiration date of the option or upon exercising of the option. 2. There should be no difference in the tax treatment between financial and non-financial companies. 3. Not as such. The premium received will be recognised as income upon exercising the option, unless the participation exemption applies. 4. On the basis of Dutch tax accounting principles, profits should be recognized when earned. With respect to option premiums received, this would generally be upon expiration date of the option or upon exercising of the option. 5. Under Dutch tax accounting principles, generally, assets are valued at cost price or the higher market value. Valuation at mark-to-market is, however, also allowed under Dutch tax accounting principles.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No.
H. Practices	
For all the above conditions is there any information as whether actual practices	No.

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may differ from legal provisions?	

POLAND

A. Securities transaction taxes

Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. Note that there is no specific tax on securities transactions or specific types of financial transactions. However, Civil Law Activities Tax (CLAT) provides for taxation of sale or exchange of property rights, which include securities and derivatives. 2. Generally, all securities / derivatives are subject to taxation. Exemptions apply to sale of Polish treasury bonds and Polish treasury bills, bills issued by the National Bank of Poland and some other specified securities. Note that the CLAT Law provides for other exemptions, of which most popular is for transactions performed within organized trade (via stock exchange). In other words, as a rule, transactions on listed securities are out of scope. However in case of some OTC transactions, even if they include listed securities, the transaction might be subject to 1% CLAT. 3. CLAT Law dated 9 September 2000. 4. Market value of securities / derivatives 5. 1%, no maximum of tax due specified 6. Upon sale / exchange transaction 7. Subject to CLAT are transactions where: - the property right is exercised in Poland (this would cover among other Polish securities) or - the property right is exercised outside Poland and the buyer is seated in Poland and the transaction was performed in Poland. 8. As a rule, the buyer is liable for declaring and paying the tax.

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B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	[In WHT section, we assume no permanent establishment exists in Poland] 1. General rules apply. 2. No. 3. Yes, received flows are taxable, however regulations are unclear with regard to timing of their recognition. A tax ruling is advisable. 4. Yes, paid flows are tax-deductible, similar uncertainty exists as in case of revenues – a ruling is advisable. 5. As a rule, no. Currently, Polish tax authorities take a position that payments under IRS (interest rate swaps) are not subject to WHT in Poland. 6. As a rule, no. 7. Business profits / capital gains / other income within the meaning of OECD Model Tax Convention.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is	[In WHT section, we assume no permanent establishment exists in Poland]

relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	1. General rules apply. 2. No. 3. Yes, doubts regarding the timing of recognition of gains / losses in tax calculation – similar to those presented in section D.2 above. 4. As a rule, gains/losses from revaluation of derivatives are not taxable. In some cases, however, where such valuation is treated in accounting as FX differences, it may be taxable. Analysis of specific cases is recommended. 5. As a rule, no. 6. As a rule, no. 7. Business profits / capital gains / other income within the meaning of OECD Model Tax Convention.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting	[In WHT section, we assume no permanent establishment exists in Poland] 1. General regime applies. Note that in case of options, a specific regulation (Art. 16 sec. 1 pt. 8b of the CIT

rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	Law) should be considered. According to this regulation, expenses connected with acquisition of financial derivatives (e.g. option premium) are treated as tax-deductible upon execution of rights resulting from these derivatives (upon exercise) or resignation of realization of these rights (upon non-exercise at expiration), or sale of these rights – provided that these expenses do not increase initial value of a fixed or intangible asset, according to specific other provisions. 2. No.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector?	1. Yes, premium paid is tax-deductible upon execution of rights resulting from the option (upon exercise) or resignation of realization of the option (upon non-exercise at expiration), or sale of the option – provided that it does not increase initial value of a fixed or intangible asset, according to specific other provisions. 2. No. 3. In our view, and based on the market practice known to us, premium paid is not a part of acquisition price of underlying stock. However, tax regulations are not fully clear in this respect. 4. (i) taxable revenue from the sale of option, tax deductible cost equal to the expenses incurred on purchase of the option; (ii) tax deductible cost equal to the expenses incurred on purchase of the option;

POLAND	
3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (lxiii) exercise of the options, (lxiv) sale of the shares acquired through the option, (lxv) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	(iii) capital gains / loss on the sale; (iv) tax deductible cost equal to the expense incurred on purchase of option. The standard 19% CIT rate applies. 5. See comments in section C.4. above. 6. No. 7. Business profits / capital gains / other income within the meaning of OECD Model Tax Convention. 8. CIT treatment is separate for particular property rights. In case of e.g. COLLAR structures where 2 opposite options are issued, they should be recognized for CIT separately.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non	1. Yes, taxable as one-off revenue, when due (i.e. on the accrual basis). 2. No. 3. No. 4. If a contract is non-delivery (cash settlement), the gains / losses are taxable / tax-deductible. In case of a delivery contract (physical settlement with transfer of underlying shares), exercise of an option will result in recognition of a tax result on the underlying security (capital gains / losses). This would be regarded as sale of the underlying shares, therefore general rules of taxation of gains/losses would apply. Note that there is no possibility to claim the participation exemption in this case.

POLAND	
Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	5. See comments in section C, pt.4
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	As a rule, no. The significant issue worth mentioning is that recently, there were court rulings which stated that in case a taxpayer was engaged in derivatives for speculative reasons, losses on these transactions cannot be tax-deductible. These rulings were issued for non-financial entities and we are not aware of such approach being presented in case of financial institutions.

PORTUGAL	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. No 2. Not applicable (N/A) 3. N/A 4. N/A 5. N/A 6. N/A 7. N/A 8. N/A
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	1. The main corporate tax regime applies. The standard CIT rate is 25% + 1.5% maximum municipal surcharge + 2.5% additional surcharge for taxable income higher than 2M€ However there are also specific rules for financial derivatives in the corporation tax code. Fair value adjustments booked in P/L accounts are, in principle, taxable / deductible. 2. No.

PORTUGAL	
1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	3. No, Fair value adjustments are relevant for tax purposes when booked in P/L accounts. The taxation only take into account the P/L adjustment booked on the value of the swap as such, independently of any payment 4. The tax treatment in this case is the same as the one described at 3. 5. No. There is no a WHT (WHT). Although the gains are considered capital gains, taxable in Portugal at a 25% rate if the income is paid by a counterparty located in Portugal. However, if (a) the financial derivative is negotiated in a exchange market, (b) the beneficial owner of the gains is a resident in a country which is not considered an off-shore (as foreseen on a specific administrative rule) and has a Double Tax Treaty (DTT) or a Tax Information Exchange Agreement (TIEA) signed with Portugal, (c) 25% or more of the beneficial owner's equity is not owned by a resident entity, there is an exemption that excludes the capital gain taxation. 6. Please see 5 above. 7. There is no guidance in this regard. In principle, the DTT may treat this kind of gains/losses as business income or other income. The classification does not depend of the nature of the underlying.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial	1. The main corporate tax regime applies. However there are also specific rules for financial derivatives in the corporation tax code. Fair value adjustments booked in P/L accounts are, in principle, taxable / deductible. 2. No. 3. Yes. Fair Value adjustments are relevant and thus payments made are not

future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	relevant. 4. In principle, yes. For both FS players and non-FS players. 5. No. There is no a WHT (WHT). Although the gains are considered capital gains, taxable in Portugal at a 25% rate if the income is paid by a counterparty located in Portugal (without a permanent establishment). However, if (a) the derivative is negotiated in a exchange market, (b) the beneficial owner of the gains is a resident in a country which is not considered an off-shore (as foreseen on an specific administrative rule) and has a Double Tax Treaty (DTT) or a Tax Information Exchange Agreement (TIEA) signed with Portugal, (c) 25% or more of the beneficial owner's equity is not owned by a resident entity, there is an exemption that excludes the capital gain taxation. 6. No WHT is levied. See 5 above. 7. There is no guidance in this regard. In principle, the DTT may treat this kind of gains / losses as business income or other income. The classification does not depend of the nature of the underlying asset.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the	1. The main corporate tax regime applies. However there are also specific rules for financial derivatives in the corporation tax code. Fair value adjustments booked in P/L accounts are, in principle, taxable / deductible 2. No.

obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options,	1. Yes. Follow accounting treatment and fair value adjustments are relevant for tax purposes. 2. No. 3. No. 4. The tax treatments for the given situations are the following: (i) Gains/losses are included in the taxable income. The standard CIT rate is applicable: 25% + 1.5% maximum municipal surcharge + 2.5% additional surcharge for taxable income higher than 2M€ (ii) The tax treatment described in (i) applies in this case. However, gains or losses should have already been reflected in the P/L accounts. (iii) If the shares are not negotiated in a regulated market or their owners have directly or indirectly, 5% or more of the company's equity, there will be a capital gain/loss as follows: (The "monetary correction factor" normally decreases the gain for tax purposes. It may increase in a deflationary scenario)

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Gains/loss = (Sale's price – operation's expenses) – (acquisition's value **x** monetary correction factor*) , (lxviii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	*Established annually by Minister of Finance' decree. Otherwise, the tax treatment is the one described in (i). The tax rate is the one described in (i) for both situations. (iv)The tax treatment follows the accounting treatment. It means that the premium has to be considered as a deductible expense in the absence of exercise of the option. 5. In principle, yes. 6. No. 7. There is no guidance in this regard. In principle, the DTT may treat this kind of gains /losses as business income or other income. The classification does not depend of the nature of the underlying. 8. Tax treatment follows accounting treatment, being the respective financial derivative taxed under the applicable relevant rule.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the	1. Yes. Follow accounting treatment and fair value adjustments are relevant for tax purposes.

PORTUGAL	
applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	2. No. 3. No. 4. Yes. 5. In principle, yes.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	No.

ROMANIA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. Yes. 2. Securities within the scope include all types of financial instruments such as equities, bonds, t-bill, derivative financial instruments. 3. The securities transaction taxes are covered by the following pieces of legislation: - Regulation No. 7/2006 regarding revenues of the National Securities Commission ("NSC"); - Emergency Ordinance No. 25/2002 for approval of the NSC Statute; - Decision No. 1/2010 for approval of the NSC budget for 2010 (Annex 1) – the NSC budget for 2011 is not yet published. 4. -5 -6 -7 -8 Below is a summary of transaction taxes applicable to transactions with securities on the local market (e.g. Bucharest stock exchange) that falls under the scope of NSC regulations: (i) For financial instruments (e.g. equities, bonds, t-bills), other than derivative financial instruments: - a commission of maximum 0.08% is applied on the value of the transactions performed on regulated markets / alternative trading systems (e.g. stock exchange); such commission is withheld on a daily basis from the buyer and it is paid by the stock exchange to the NSC;

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	- a monitoring fee of 0.15% is applied on the value of the transaction reported, which are derived outside the regulated markets (e.g. over the counter/"OTC"); such fee is withheld on a daily basis from the buyer and paid by the intermediary (e.g. broker, investment management companies, etc.) to the NSC; (ii) For derivative financial instruments: - a commission of 0.10 RON/contract is applied for transactions derived on regulated markets/alternative trading systems (e.g. stock exchange); such commission is withheld on a monthly basis from both the buyer and the seller and paid by the stock exchange to the NSC.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how?	[General comments to be kept in mind in the rest of the questionnaire: ▪ The financial instruments analysed below (i.e. equity swaps, financial futures, call options on stocks) qualify as derivative financial instruments under the current Romanian legislation. ▪ The legal ownership upon the underlying security (i.e. equity) under a swap contract is not transferred from one counterpart to the transaction to the other. ▪ The below comments cover the fiscal implications for both resident legal entities, as well non-resident legal entities, as counterparts to transactions. ▪ The standard Romanian corporate income tax ("CIT") rate is of 16%. ▪ The standard Romanian WHT ("WHT") rate is of 16%. It should be noted that the Romanian tax legislation is not well developed in

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4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	terms of treatment applied to derivative financial instruments. However, there is a general substance over form provision according to which the Romanian tax authorities can reclassify transactions based on economic substance. To the best of our knowledge, to date we are not aware of any such reclassifications applied to derivative financial instruments. Nonetheless, our answers set out below may change if the tax authorities would claim tax law abuse and seek to reclassify such transactions / instruments. We have not undertaken an analysis of the accounting treatment applied to the derivative financial instruments in question. We have only indicated potential accounting implications where these were relevant for understanding the underlying tax treatment and as such our answers should not be viewed as an accounting advice.] There is currently a deficiency in the Capital Markets domestic legislation in terms of qualification of the swap contracts as derivative financial instruments. However, based on general practice, as well as considering other legislative grounds, we are of the view that the swap transactions should be regarded as derivative financial instruments both from an accounting and tax perspective. Our answers under this equity swaps section are based on the assumption that legal ownership over the equity is not transferred (otherwise a case by case analysis would be needed). 1. and 2. There are no specific rules providing for different tax implications for swap transactions performed between parties in the non-Financial Sector, as compared to the case where at least one party is a company acting in the Financial Sector. The general tax rule for evaluation and execution of derivative financial instruments is presented at questions 3 and 4 below.

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	However, we are aware of a letter issued by the Ministry of Finance according to which losses from evaluation and execution of currency hedging contracts should be considered as non-deductible by regular companies, whenever such operations are not performed with authorised intermediaries (e.g. credit institutions). More precisely, there is a risk that the Romanian tax authorities would challenge the deductibility of expenses incurred by a regular company with revaluation/execution of derivative financial instruments (e.g. swap contracts) which are not performed with authorised intermediaries. Swap transactions between Romanian legal entities 3. and 4. As a general tax rule, the income and expenses generated by the evaluation and execution of derivative financial instruments should be taken into account as taxable income / deductible expenses as long as they are recorded in the books according to the accounting regulations and in the periods in which they relate to. Note that as per the Romanian accounting statutory rules applicable to regular companies, derivative financial instruments should be held at amortised cost (except for consolidated financial statements where mark-to-market is allowed). For Romanian financial institutions, derivative financial instruments are generally marked-to-market. In case of Romanian private pension funds, the law governing their activity provides for an exemption from taxation of the investments of their assets, as well as the investments results. Such investments cover also transactions with derivative financial instruments. Swap transactions involving a non-resident party 3. and 5.

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	While the legal ownership upon the underlying security /equity is not transferred between parties, the flow of payments to a non-resident party under a swap transaction should in principle not be subject to WHT in Romania as such income is not listed as a type of taxable income for non-residents. If the legal ownership upon the equity would be transferred to the non-resident, then the nature of the income obtained by the latter should be analysed on a case by case basis (e.g. capital gain in relation to equity, dividends) for assessing the WHT implications in Romania. We are however not in the position to confirm if legal ownership is transferred or not, as we do not know how the product is structured. 6. There are no specific provisions in the current tax law covering the taxation of income derived by non-residents from the transfer/sale of derivative financial instruments. Such income is not specifically listed as a taxable income in Romania. We must note that until 1st July 2010, the Romanian Fiscal Code specifically provided that the income derived by non-residents from the transfer of derivative financial instruments is not taxable in Romania. Starting with 1st July 2010, this provision has been repealed and no further norms for clarifying the amendment have been published in this respect. Therefore, it must be noted that the intention of the legislator is not very clear in what concerns taxation of derivative financial instruments. However, in the absence of any specific provision in the Romanian tax legislation in respect of the taxation of non-residents when transferring the derivative financial instruments, it appears that any income derived as such by non-residents may be considered non-taxable in Romania. 7. As mentioned in our answer to question 5 above, absent any specific provisions and assuming that there is no transfer of legal ownership of the

	underlying asset under the swap, it appears that such payments would be outside the scope of WHT in Romania. In such cases, double tax treaty protection should also be available (assuming there is a double tax treaty concluded with that country) as such income may fall under the following articles: Other Income or Business Profits (depending on the activity performed by the non-resident entity).
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the	1. and 2. Please refer to answers provided under section B above (questions 1 and 2). 3. Same tax treatment as detailed under section B above (questions 3 and 4). 4. Under the Romanian statutory accounting legislation for regular companies, the general evaluation principle applying to financial instruments (e.g. futures) for purposes of presentation in the annual financial statements is evaluation at cost (i.e. no impact in the profit and loss account), except for consolidated financial statements, where there is a possibility to apply the method of valuation at fair value. For financial institutions however, such instruments are generally marked-to-market. 5. The income derived by a non-resident, counterparty to a financial future appears not to be subject to WHT in Romania, subject to the same reasoning as mentioned under section B (question 6) above, i.e. such income is not listed as a taxable income in Romania. 6. Same tax treatment as detailed under section B (question 6) above. 7. As mentioned under question 5 above, such payments appear not to be subject to WHT Romania. Double tax treaty protection may also be available for the non-resident (assuming there is a double tax treaty concluded with that

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connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	country). Such income may fall under the following articles: Other Income or Business Profits (depending on the activity performed by the non-resident entity).
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. and 2. Please refer to answers provided under section B above (questions 1 and 2).
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not	1. The tax treatment of the premium expense (at the level of the holder of the option) is not expressively regulated under the tax legislation. However, in

cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer.

1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?
2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector?
3. Is the premium paid part of the stock acquisition price?
4. Please describe the tax treatment of the gains or losses realised at the following events:
   - (i) disposal of the options,
   - (lxix) exercise of the options,
   - (lxx) sale of the shares acquired through the option,
   - (lxxi) expiration of option (without exercise or disposal)
5. Is mark-to-market applied?
6. Is there a WHT on premium to non-residents?
7. How are the premium payments classified under the double tax treaties?
8. How are options treated when they are part of a packaged product (e.g. equity linked note)?

our opinion, according to the general deductibility rule provided by the Romanian Fiscal Code, such expense would be tax deductible as it is incurred for the purpose of generating taxable income. Moreover, the premium expense could also be regarded as deductible, based on the general deductibility rule provided under section B above (questions 3 and 4) i.e. deductible expense derived further to the execution of financial derivative instruments.

From an accounting perspective, the premium expense may be booked at the acquisition date of the option. In such case, considering that the tax treatment follows the accounting one, the premium expense would be taken as a deductible item when being registered in accounting (i.e. acquisition date).

2. There are no differences in terms of deductibility of premium expense in the cases mentioned.

3. Please refer to answers from question 1 above.

4.

<u>Holder – resident legal entity:</u>

Any income derived in relation to the scenarios described (i ii, iii and iv) would be taxable, while the expenses incurred would be tax deductible, from a profit tax perspective.

<u>Holder – non-resident entity:</u>

(i) Same tax treatment as provided under section B above (question 6).

(ii) Expenses recorded at the level of the non-resident holder– no tax implications in Romania.

(iii) The capital gain derived by a non-resident when selling the shares in Romanian

	companies which were acquired through the option is taxable in Romania, but generally tax treaty protection may be available. When such income is derived on foreign capital markets, the income obtained by the non-resident is non-taxable in Romania. There is also an exemption under the law according to which capital gains obtained by non-resident collective investment vehicles without legal personality from the transfer of shares held into Romanian entities are not subject to taxation in Romania. (iv) No tax implications in Romania. 5. Please refer to answers provided under section C above (question 4). 6. There are no specific provisions in the Romanian legislation covering the taxation (WHT) of the premium paid to the writer, a non-resident legal entity. Such income is not listed as a taxable income in Romania. In such case, we are of the view that the premium paid to the writer should not be subject to WHT in Romania. 7. Most of Romania's double tax treaties follow the OECD Model Tax Convention. Thus the premium income may fall under any of the following articles: Other Income or Business Profits (depending on the activity performed by the non-resident entity). 8. There are no specific tax provisions in the Romanian legislation for the fiscal treatment applicable in the cases described. In such case, we are of the view that each element / transaction of the packaged product should be analysed separately from a tax perspective.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not	1.

ROMANIA	
cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	<u>Writer –resident entity:</u> The income derived from the premium is a regular taxable item for profit tax purposes, when being registered into accounting. <u>Writer –non-resident entity:</u> Please refer to answer provided under section E above (question 6). 2. There are no differences in terms of taxation of premium income in the cases mentioned. 3. Please refer to answers from question 1 above. 4. The income derived from the premium is taxed as described at 1. The losses realised on the exercise should be deductible based on the general rule that they are incurred with a view of obtaining taxable revenues (in this case, the premium). 5. Please refer to answers provided under section C above (question 4).
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	It should be noted that the practice of the Romanian tax authorities in terms of taxation of derivative financial instruments is not so advanced at this stage. As seen above, there are items of taxation not yet specifically addressed in the Romanian tax legislation in terms of derivative financial instruments. However, when assessing the tax treatment of derivative financial instruments it is likely for the Romanian tax authorities to regard with priority the

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	accounting treatment of such items, as well as the legal ownership of the underlying asset. Given the lack of specific guidance in the area of tax law, the differences in tax treatment may depend on the legal form of the contracts. We therefore recommend having such contracts reviewed on a case-by-case basis from a Romanian perspective.

SLOVAKIA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	[With effect from 1 January 2011 Slovakia introduced emission-tax in its tax system. Subject to emission-tax are emission quotas (EUAs) that are registered in the years 2011-2012 and that remain unused or are transferred to other party. The tax base is the sum of transferred and unused emission quotas multiplied by price per quota published by the Ministry of Finance. The tax rate is 80% of the tax base. The taxpayer of the emission-tax is the EUA-entrepreneur i.e. the one for whom EUAs quotas were registered based on the respective provisions of the Act on Trading with Emission Quotas.]
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	1. The Slovak tax law does not address the taxation of SWAPs in particular. Slovak tax rules relate to the derivatives as a group of financial instruments, including SWAPs. In general, the overall loss from transactions with derivatives incurred in the taxation period is tax non-deductible. Two exemption exist where the cost incurred are fully tax deductible regardless of the income from derivatives:

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1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	- If the tax payer is a company in Financial Sector (the tax law states the list of entities in scope); - In case where hedging instruments are subject to the transaction. Cumulative gain from transactions with derivates incurred in the taxation period is taxable. The tax treatment of the cost incurred in transactions with derivatives follows their accounting treatment. The Slovak accounting standards follow the IFRS in the section relating to financial instruments. 2. The cumulative loss from transactions with derivatives over the whole tax period incurred by a company in non Financial Sector is tax non deductible in Slovakia. The cumulative profit would be fully taxable. 3. & 4. From tax perspective, the cumulative result of the transactions with derivatives for the whole tax period is taken into account. If such result is the cumulative loss this would be non-tax deductible unless the tax payer is a financial institution. The unrealised gain/loss from the revaluation of derivates traded on non-public market as at the last day of the accounting period should be included in the balance sheet and hence, are not taxable/deductible. In case of derivates classified

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	as trading derivate traded on domestic or foreign stock market or on other public market, the revaluation gain/loss should be included in the profit and loss account and subsequently taxed. The cash payments will be settled against the balance sheet accounts. The cumulative gain from the derivates for the whole tax period is subject to the standard CIT rate of 19 % (if not exempt from CIT). The CIT is the same for companies in Financial Sector and for other companies. For the tax deductibility of loss from transaction with derivates please see our comments in point 1. The Slovak tax legislation does not recognise a capital gain tax. Capital gains are taxed with the general CIT rate of 19 %. 5. Revenues received by Slovak tax non-resident (who has no permanent establishment in Slovakia) from an operation with derivatives paid by a Slovak tax resident or by a PE of a foreign tax resident would be subject to 19% Slovak WHT. This tax rate could be reduced by the respective double tax treaty. 6. A sale of a Slovak swap by Slovak tax non-resident (who has no PE in Slovakia) would be treated as Slovak-source income only if acquirer of the swap is a Slovak tax resident or a foreign tax resident with a PE in Slovakia to which the acquisition could be attributed. Such Slovak-source income would be subject to 19% tax securement on the amount paid, reduced by the respective double tax treaty.

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	7. Income from swap would be classified as Other income, and income from the sale of the swap as Capital gain, following the classification of articles in OECD double tax treaties, and thus taxable in the residence country of the seller. This classification does not depend on the nature of the underlying asset.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax?	The same treatment as described under section B applies for Financial Futures respectively, as there are regarded as derivatives. 4. The mark-to-market revaluation or "qualified valuation" should be applied as at the balance sheet date. The mark-to-market revaluation of Financial Futures should be done using market price from the public market. If this is not possible then the "qualified valuation" should be used. The qualified valuation in case of derivates uses the valuation model with verifiable data, e.g. exchange rates published by the National Bank of Slovakia or by the European Central Bank, publicly available ratings published by the rating agencies. In case, it is not possible to make the qualified valuation or the cost for it are inadequate high compared to its significance, then the revaluation would not be included in the accounting books, unless it is obvious that the derivate has been devaluated.

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7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	The same treatment as described under section B applies for Call options respectively, as there are regarded as derivatives.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax	1. The premium paid for call option is not tax deductible for the holder. This is because it should be included in the acquisition price of the respective stock. 2. Yes, the premium would be tax deductible if the holder is a financial institution defined in the Slovak income tax act.

treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer.

1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?

2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector?

3. Is the premium paid part of the stock acquisition price?

4. Please describe the tax treatment of the gains or losses realised at the following events:

   (i) disposal of the options,

   (lxxii) exercise of the options,

   (lxxiii) sale of the shares acquired through the option,

   (lxxiv) expiration of option (without exercise or disposal)

5. Is mark-to-market applied?

6. Is there a WHT on premium to non-residents?

7. How are the premium payments classified under the double tax treaties?

8. How are options treated when they are part of a packaged product (e.g. equity linked note)?

Our description relates to the difference between FS and non-FS companies in the tax treatment of costs related to derivates in general. Regarding the premium paid for call option on stock, the treatment is the same for FS and non-FS companies, i.e. should be included in the acquisition price of the stock.

3. The premium on call option on stock should be included in the stock acquisition price when exercised.

4. (i) In general, a loss from disposal of the option is tax non-deductible. The loss would be treated as tax deductible only if the tax payer is a company in Financial Sector (the tax law states the list of entities in scope). The profit from disposal of the option is taxable for FS and non-FS companies.

   (ii) Not applicable, as the premium would be included in the stock acquisition price. The same treatment applies for FS and non-FS companies.

   (iii) In general, loss from sale of shares is tax non-deductible. However, under certain conditions loss generated on sale of shares could be treated as tax deductible. The profit from sale of shares is taxable for FS and non-FS companies.

   (iv) The premium would be tax deductible if the holder is a financial institution defined in the Slovak income tax act. The deduction occurs at expiration.

5. The mark-to-market revaluation or qualified valuation should be applied as at the balance sheet date.

6. Premiums received by Slovak tax non-resident (who has no PE in Slovakia) paid by a Slovak tax resident or by a PE of a foreign tax resident would be subject to 19% Slovak WHT. This tax rate could be reduced by the respective double tax treaty.

7. Income from premium would be classified as Other income following the classification of articles in OECD double tax treaties.

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	8. Options being part of packaged product are not common in Slovakia. In general, the tax treatment of options under equity linked note should not differ from the tax treatment valid for call option.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. The premium revenue should be included in the general tax base of the writer in the tax period when exercised. Before exercise, the premium has no P&L impact. 2. No. 3. No. Upon delivery, the writer accounts for a capital gain/loss and the premium is released into P&L as an income. 4. In general, loss from sale of securities is tax non-deductible. However, under certain conditions loss generated on sale of securities could be treated as tax deductible. 5. The mark-to-market revaluation or qualified valuation should be applied as at the balance sheet date.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	The same treatment for a subsidiary or a branch of a non-domestic institution as for domestic institution would apply under the assumption that (i) the subsidiary of a non-domestic institution is Slovak tax resident and (ii) the branch of a non-domestic institution is has a PE in Slovakia

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	to which the transaction with derivates under review could be attributed.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	We are not aware of situation where the actual treatment of derivates would differ from the legal provisions relating to them. However, based on our practical experience, for each transaction with derivates the contractual documentation should be examined in detail to apply to correct tax treatment.

SLOVENIA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	There are no securities transactions taxes in Slovenia.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	1. The general tax regime applies as Slovenian tax law does not specifically address the tax treatment of equity swaps. 2. There should not be a difference in the tax treatment, except to the extent that there is a different accounting treatment. 3. The tax law does not address the tax treatment of the payments received. This should be based on the accounting treatment. Most financial services companies and many large companies in Slovenia prepare their accounts under IFRS. Thus

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1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	the income is likely to be taxed at the standard CIT rate of 20% when it is accrued for accounting purposes, unless it is classed as dividends, in which case it will be taxed in the period of receipt (the payment may be classed as a dividend if it is accounted for as a profit share derived from securities or profit participating loans). Dividend income is effectively 95% exempt from Slovenian corporate tax if certain conditions are met (in particular, for the exemption to apply, dividends should not be received from a company resident in a tax haven (a non-EU country with a general or average nominal corporate tax rate of 12.5% or less, which is included on a list published by the Ministry of Finance and the tax authority)). 4. Payments that are posted to the P&L account as expenses should be tax deductible unless they are items specifically treated differently in the tax law (e.g. dividends), or they are not incurred by the company with a view to making a taxable profit. 5. This would depend on the exact nature of the payment. Under Slovenian law, WHT of 15% applies to dividends, income similar to dividends, royalties, interest and lease payments for Slovenian real estate. 6. WHT should not apply on sale of a swap. 7. Payments under the swap would probably be classified under other income or possibly dividends, and payments related to the sale of the swap would probably fall within capital gains.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy	1. See our answers to question 1 under section B above. 2. See our answers to question 2 under section B above. 3. A gain on a future should be taxed within the corporate tax base, in the period of sale (i.e. when the sale becomes legally effective and is recognised for accounting

or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	purposes) at the standard CIT rate of 20%. A loss should be tax deductible. 4. The tax law does not address this, but movements posted through the P&L would generally be taxable / tax deductible, whereas movements posted through equity would not. 5. There should be no WHT on payments on the expiration of futures. 6. There should be no WHT on payments to non-residents on the sale of futures. 7. Payments on expiration of the futures would probably be classified under other income. and payments on the sale of the swap under capital gains.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the	1. The general tax regime should apply as there are no specific tax rules applicable to call options. 2. There should not be a difference in the tax treatment, unless there is a different accounting treatment.

obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options,	1. We would expect the premium paid to be viewed as part of the cost of the option and, after exercise, the stock, and thus as tax deductible in calculating the gain on eventual sale of the stock. 2. There should not be a difference in the tax treatment, unless there is a different accounting treatment. 3. The premium should be treated as part of the acquisition price. 4. (i) A gain or loss on disposal of the options or sale of the shares should be taxable at the standard CIT rate of 20% / tax deductible within the corporate tax base. (ii) Exercise of the options is unlikely to give rise to a taxable event. (iv) On expiration of the options, the premium paid should be tax deductible, although for a non-financial services company, the tax authorities may take the view that the cost was not incurred to generate taxable income of the company, in which case they could disallow the deduction. (iii) There is an effective 47,5% exemption for capital gains on sale of shares where the seller has at least 1 employee, and the shareholding was at least 8%

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(lxxv) exercise of the options, (lxxvi) sale of the shares acquired through the option, (lxxvii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	directly held for more than 6 months, 5. The tax law does not address this, but movements posted through the P&L would generally be taxable / tax deductible, whereas movements posted through equity would not. 6. There should not be a WHT on the premium. 7. Premium payments may be classified under capital gains or under other income. 8. The tax law does not address this.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed?	1. For writers, the premium should be taxable as income in line with the accounting treatment at the standard CIT rate of 20%. It should be taxable when recognised as income in the P&L. 2. There should not be a difference in the tax treatment, unless there is a different accounting treatment. 3. The tax treatment should follow the accounting treatment. Based on the example provided, the premium of 10 is likely to be taxable as income, and the gain of 20 as a gain, although this would depend on the accounting treatment. Gains on sale of shares would not be exempt unless the seller had held at least 8% of the shares for at least six months, so in this case it is likely that the 30 should be taxable at the standard CIT rate of 20%. 4. Gains and losses on exercise should be taxable / tax deductible in the hands of the writers. 5. The tax law does not address this, but movements posted through the P&L would generally be taxable / tax deductible, whereas movements posted through equity

SLOVENIA	
5. Is mark-to-market applied?	would not.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	The tax treatment should not differ if the institution is domestic, or is a subsidiary or a branch of a non-domestic institution. However, please note that investment funds and fund management companies pay corporate tax of 0% if they distribute at least 90% of the operating profit generated in the previous tax year by 30 November of the tax year in question. Pension funds and insurance undertakings authorised to operate under the Act regulating pension and disability insurance also pay tax at 0% on activities related to the pension scheme. Also, impairments of loans are tax deductible for banks when booked, but for all other companies, loan impairments are only deductible within certain limits and if certain conditions are met.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	The tax treatment of the types of financial instruments described above is not specifically addressed in the Slovene tax law. We have therefore based our answers on our understanding of the financial instruments and how the general provisions of the tax law are likely to apply. However, we do not have any information on how such items are taxed in practice since so far they are not commonly used in Slovenia.

SPAIN	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	Initially there are no securities transactions taxes in Spain, although some regions established taxes on deposits.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time.	1. General Tax regime is applicable 2. Initially there should not be differences if one or both of the counterparties are companies in the non Financial Sector. Nevertheless, as taxable base is based on the accounting result (with some exceptions) please note that there are different accounting rules for Banks and other entities subject to the supervision of the Central Bank; Insurance companies; mutual funds; entities subject to the general accounting rule; etc. and consequently differences could exist depending on the

SPAIN	
1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	industry we deal with. 3. & 4. Taxation on flows will depend on several factors, as for instance tax residence of the parties involved, qualification of the payments, etc. In general terms, for Spanish CIT purposes, it does not exist a specific tax treatment for derivatives and, therefore, the general rules for determining the taxable base derived from them should be applied. These general rules imply that the taxable base should be calculated by applying the accounting principles for determining profits and adjusted only where a Corporate Tax Law mandates, and this taxable base will be subject to a 30% tax rate. The Spanish accounting standard on the recognition and measurement of financial instruments (which it is based in the Number 39th International Accounting Standard) establishes a specific accounting treatment for derivatives transactions that are considered as hedges, what has tax implications especially for the rhythms of accounting recognition of revenues and expenses, depending on the accounting treatment applicable to the hedged assets or operations. According to such accounting standard, there are two categories of hedges: i. A fair value hedge: The gain or loss from the change in fair value of the hedging instrument is recognised immediately in the profit and loss account. There is uncertain on the specific tax treatment to be applied to the deductibility of the tax losses and it would be certain risk that the tax authorities only accept the deduction of a loss at the time this loss is realised. ii. A cash flow hedge: The portion of the gain or loss on the hedging instrument

	that is determined to be an effective hedge is recognised in a first stage in equity and it should be recognised in the profit and loss account in the period/s in which the financial asset or liability is actually accrued. This treatment would in principle have tax effects. 5. & 6. & 7. WHT will depend on the qualification of the gain/income and the country of residence of the parties involved on the financial transaction. As there are no specific rules for derivatives products in terms of qualification of income, this issue should be analysed on a case by case basis. In general terms, it could be assumed that the gain or income to be obtained by a non-resident on swaps would be qualified as (i) capital gain, (ii) business profits or, alternatively, (iii) "other income" (the qualification will not depend on the underlying). In any case the gain/income obtained in Spain would be subject to taxation (at the 24% general rate or at capital gain rate -19%-), except Treaty or domestic exemptions could be invoked. WHT would depend on the final qualification and the tax residence of the counterparty.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial	1. General Tax regime is applicable 2. See B.2 above.

SPAIN	
future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	3. & 4. See B.3 above. 5. & 6. & 7. See B.5 above
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date	1. General Tax regime is applicable 2. See B.2 above.

(the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (lxxviii) exercise of the options,	1. According to accounting rules 2. See B.2 above. 3. According to accounting rules 4. (i) Tax effects according to accounting rules (ii) Tax effects according to accounting rules. (iii) Capital gain obtained on the disposal of the shares will be included on the taxable base and subject to taxation at general tax rate, according to the tax value of the assets (tax acquisition price +/- tax deductible impairments). (iv) According to accounting rules 5. According to accounting rules. See B.3 above. 6. & 7. See B.6 above. 8. It will depend on the specific product. We would need additional information on

SPAIN	
(lxxix) sale of the shares acquired through the option, (lxxx) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	the linked note to establish potential tax implications.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. Yes, according to accounting rules. 2. See B.2 above. 3. According to accounting rules 4. Depending on the taxation applied on the accounting treatment already applied (see B.3 and E.4.iii above) 5. According to accounting rules.

SPAIN	
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	See B.2 above.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	It will depend on the real economic/tax purpose of the transaction.

SWEDEN	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. No, Sweden does not impose transaction taxes on financial instruments or financial contracts. 2. N/A 3. N/A 4. N/A 5. N/A 6. N/A 7. N/A 8. N/A
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions	1. Where both parties are companies in the Financial Sector the general tax regime, based on accounting treatment, will apply 2. For a party which is not a financial company the capital gains rules apply, which typically deviate from the accounting treatment in terms of timing (recognition of gains or losses). For a financial company answer #1 will apply irrespective of the status of the counterparty. 3. Financial company - taxable when accrued, non-financial company - taxable when received. They are taxable at the standard CIT rate which is 26,3% and

SWEDEN	
(where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	which is the same between FS and non-FS companies. No differentiation is made between CIT and capital gain tax (CGT), as CGT is integrated in the CIT system. 4. Financial company - deductible when accrued, non-financial company - deductible when paid, but only from capital gains on shares and equity-based securities. 5. No 6. No 7. N/A
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how?	1. Where both parties are companies in the Financial Sector the general tax regime, based on accounting treatment, will apply 2. For a party which is not a financial company the capital gains rules apply, which typically deviate from the accounting treatment in terms of timing (recognition of gains or losses). For a financial company answer #1 will apply irrespective of the status of the counterparty 3. Gains: Financial company - taxable when accrued, non-financial company - taxable when received Losses: Financial company - deductible when accrued, non-financial company - deductible when paid, but in the case of futures over shares or equity based

SWEDEN	
4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	securities only from capital gains on shares and equity-based securities. 4. For financial companies, yes, but with an option to use cost instead of fair value, provided that cost is used for all securities in the company. 5. No 6. No 7. N/A
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. Where both parties are companies in the Financial Sector the general tax regime, based on accounting treatment, will apply 2. For a party which is not a financial company the capital gains rules apply, which typically deviate from the accounting treatment in terms of timing (recognition of gains or losses). For a financial company answer #1 will apply irrespective of the status of the counterparty.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any	1. If the option is used to acquire stock the premium is carried over as cost for the

SWEDEN	
other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (lxxxi) exercise of the options, (lxxxii) sale of the shares acquired through the option, (lxxxiii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	acquired stock. If the option expires the premium is deductible as a loss. 2. The differences apply to losses at expiration and are as follows: The financial company may deduct an anticipated (unrealised) loss and may deduct it from any kind of income. The non-financial company may only deduct realised losses, and only from capital gains on stocks and other equity based securities. 3. Yes 4. (i) taxable or deductible under the principles described in 2 above (ii)not a taxable event, premium is carried over to the acquired stock as part of the cost (iii)taxable, premium is part of the cost for the shares (iv)a loss deductible under the principles described in 2 above 5. Only for financial companies, see answer C.4 above. 6. No 7. This is not totally clear, but it should probably be “other income” 8. The product is normally treated as a package for tax purposes, and will be seen as an equity-based security.

SWEDEN	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. Financial companies: The premium is taxable when it is recognised in the P/L account. It should be recognised when the writer is relieved from the liabilities under the contract (when the option is settled in cash, at delivery of the underlying securities or at expiration) or, if applicable, at the recognition of an unrealised liability under the contract on an accruals basis. 2. Non-financial companies: The premium is taxable either when the option expires (for 'marketable' options with a term not exceeding twelve months) or immediately (other options). 3. Yes, see previous response. 4. Yes, if delivery is made under an option with a term not exceeding twelve months. 5. Financial companies: yes, always. Non-financial companies: capital gains are taxable but capital losses may only be deducted from capital gains on stocks and other equity based securities 6. Yes, but only for financial companies.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	Actual practices should conform to the legal provisions. Any deviations would be incidental and unintended.

THE UNITED KINGDOM

A. Securities transaction taxes

Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? Who is liable for levying the tax? Who is liable to support the tax?	1. There are securities taxes which apply to the transfers of financial instruments and these transaction taxes - Stamp Duty and Stamp Duty Reserve Tax - broadly apply to the transfer of equities and certain equity derivatives and also some loans which have equity like features (e.g. convertibles). 2. The securities in scope are broadly equity and equity derivatives with loan capital generally being exempt except where it has equity features such as convertibles as mentioned above. All cash settled derivatives are outside the scope of the tax. 3. There are very many charging provisions under these rules, but the most important is FA 1986, Section 87 which imposes a 0.5% charge on transfers of chargeable securities within scope of SDRT. There are also higher charges where securities are put into a depository receipt or clearance service facility. 4. The tax base in relation to the usual 0.5% charge on transfer is the existence of an "agreement to transfer" of a security within the scope of the rules. 5. The tax rate is 0.5% on chargeable transfers with a higher rate of 1.5% where securities are put into a clearance service or depository receipt scheme. There is no maximum amount of tax due. 6. The tax event is crystallised by entering into an agreement to transfer or entering into an arrangement to put securities into a depository receipt or clearance service facility. 7. In broad terms, the taxes have no territorial scope and are global. The UK Stamp Duty Reserve Tax applies to shares issued by UK incorporated companies. Certain recognised intermediaries (Financial Sector traders) are given an exemption for transactions in securities to promote liquidity where a transaction takes place on a recognised market or takes place in relation to a share which is normally dealt with on a recognised market.

THE UNITED KINGDOM	
	8. It is the transferee who is normally liable for the duty, although a professional intermediary may have an obligation to act as an "accountable person", on behalf of such a transferee meaning that such a professional intermediary will have to account for the tax due and notify the tax authorities of the charge on behalf of the non-professional intermediary who is ultimately liable for tax.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties	1. We have a specialist derivatives contracts code which provides a number of extremely detailed rules that apply to transactions involving derivatives. These rules are capable of applying irrespective of whether the parties are in the Financial Sector or not, but in some cases the underlying subject matter may take the swap transaction outside of these rules and back into our ordinary capital gains rules. 2. As noted above there is not necessarily a difference with the application of a derivative contracts rules if one of the parties is a non-Financial Sector party but the way the rules will actually work in technical terms may be slightly different. If a non financial trader is involved and the underlying subject matter relates to equities, then it is possible that the derivative contract rules will be made inapplicable, in which case our general capital gains rules would apply and in this case it would be likely that the equity swap would be hedging a capital asset of the taxpayer concerned. 3. Generally the flows of payments under such swaps are taxed. This is normally on an accounts basis but if a capital gains basis applies then the rules will operate effectively on a cash/disposal basis. 4. Flows of payments made are generally tax deductible either on an accounts basis where the derivatives contract rules apply or alternatively under our capital gains rules in which case the deduction is given by way of taking account of any costs as part of the base cost in calculating any gain arising on disposal.

(other, capital gain,…)? Does the classification depend on the nature of the underlying?	5. There is no WHT on payments to non residents under the swap. 6. There is no WHT on payments to non residents on the sale of the swap. 7. We would generally classify swap payments as being "other income" for double tax treaty purposes and the classification would not normally depend on the nature of the underlying reference asset.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting	(the following answers mirror those given for section B above as the tax treatment will generally be the same) 1. We have a specialist derivatives contracts code which provides a number of extremely detailed rules that apply to transactions involving derivatives. These rules are capable of applying irrespective of whether the parties are in the Financial Sector or not, but in some cases the underlying subject matter may take the swap transaction outside of these rules and back into our ordinary capital gains rules. 2. As noted above there is not necessarily a difference with the application of a derivative contracts rules if one of the parties is a non-Financial Sector party but the way the rules will actually work in technical terms may be slightly different. If a non financial trader is involved and the underlying subject matter relates to equities, then it is possible that the derivative contract rules will be made inapplicable, in which case our general capital gains rules would apply and in this case it would be likely that the financial futures would be hedging a capital asset of the taxpayer concerned. 3. Generally the flows of payments under such financial futures are taxed. This is normally on an accounts basis but if a capital gains basis applies then the rules will operate effectively on a cash/disposal basis. 4. Flows of payments made are generally tax deductible either on an accounts basis

factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	where the derivatives contract rules apply or alternatively under our capital gains rules in which case the deduction is given by way of taking account of any costs as part of the base cost in calculating any gain arising on disposal. 5. There is no WHT on payments to non residents under the financial futures. 6. There is no WHT on payments to non residents on the sale of the financial futures. 7. We would generally classify financial futures payments as being "other income" for double tax treaty purposes and the classification would not normally depend on the nature of the underlying reference asset.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial	1. As a general matter we would expect the derivative contracts rules to apply in most cases. But, as noted above, there may be circumstances where the nature of the underlying reference asset prevents the derivative contracts rules applying in the case of a non financial trader, in which case the capital gains rules would apply. In addition to the direct tax rules, Stamp Duty and SDRT would typically also apply to dealings in call options. Any stamp or SDRT charge would be at the 0.5% rate. 2. It is possible that there may be a difference in the treatment of the transaction if one or both of the counterparties are companies outside the Financial Sector entering into the trade other than as a trading transaction (e.g. to hedge a capital gains asset). In this case, it would normally be expected that the capital gains rules would apply.

Sector?	
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (lxxxiv) exercise of the options, (lxxxv) sale of the shares acquired through the option, (lxxxvi) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents?	1. Generally the premium is deductible and this would often be under the derivative contracts rules. In the case of a non financial trader who was entering into the acquisition of capital assets, then a deduction might alternatively be obtained on disposal of the subsequent asset obtained on the basis that the cost of the premium paid is rolled into the cost of the asset ultimately acquired. 2. As indicated above, there may be situations in which there is a difference between a Financial Sector holder, and a non-Financial Sector holder. For a non-Financial Sector holder, a capital gain treatment is more likely. 3. The premium paid by a Financial Sector trader, (or by a non-Financial Sector taxpayer who is entering into a trading transaction), will normally be taxed following the accounting treatment. For non Financial Sector taxpayers who are not entering into the transaction in the course of carrying on a trade or business, however, the premium paid will typically be treated as part of the stock acquisition price, and therefore recognised on a subsequent disposal of the asset acquired. 4. (i) Where there is a disposal of the options, this will be taxed following the accounts under the derivative contracts rules, or it might also be a capital gains event, in the event that the acquisition and disposal of the options falls outside the derivative contract rules. (ii) In the event of the exercise of the options, a financial trader would be taxed following the accounting treatment, whereas a non-financial trader not entering into the transaction as part of its trade or a trade or business, would typically see an exercise of the options giving rise to the asset acquired, in which case the cost of the exercise of the options would be treated as part of the cost of the asset

THE UNITED KINGDOM	
7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	acquired. (iii) Where the shares acquired through the options are subsequently sold, a financial trader will be taxed following the accounts under the derivatives contract rules, and a non-financial trader acting other than in the course of carrying on a trade or a business will be treated as making a disposal, but with base cost including the cost of the option and the cost of the shares (e.g. the cost of the shares acquired on payment of the strike price under the option). (iv) In the event that the option expires without exercise or disposal, then this would be taxed following the accounts in the case of a financial trader, but in the case of a non-financial trader acting other than in the course of its trade or business, it is possible that the capital gains rules would apply, in which case a disposal basis of taxation would apply. In very rare cases, the cost of the option may be treated as reduced by a "wasting" formula, so that the full amount of the payment for the option is not recognised for tax purposes. 5. Mark to market may be applied in some situations. 6. There is no WHT on premium payments paid to non-residents. 7. Premium payments, if in the nature of income, would be regarded as "other income" for double tax treaty purposes, but in other cases they would not be expressly characterised by double tax treaties. 8. Where options are part of a packaged product such as an equity linked note, then they would be taxed following the accounts under the derivative contract / loan relationship rules. In the case of a financial trader, and for a non-financial trader they would be typically be taxed as a loan relationship (i.e. loan), until the point of conversion, in which case there would be a roll over of the cost of the loan into the asset acquired.

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F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	1. Writers are extremely likely to be financial traders, and therefore any premium received will be taxable following the accounts under the derivative contract rules. In the rare instances that the writer is not a financial trader, and a capital gains basis applies, then the premium received could be regarded as capital proceeds for the disposal of an asset (the writing of the option) and taxed as such. 2. There may be a difference if the writer is a bank or insurance company, or a company active in the non-Financial Sector, as discussed above. 3. The premium received will be taxed following the accounting treatment for financial traders, and for non-financial traders, it is possible that the premium received could be seen as part of a stock delivery price. 4. Gains and losses upon exercise are always taxed for financial traders following the accounts basis of computation. For non-financial traders, there may be some situations in which the gain and loss upon exercise is simply rolled into the shares acquired, as discussed above. 5. Mark to market may be applied in certain circumstances.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	There is generally no difference to all of the above answers above, depending upon whether the institution concerned is a domestic one, or a subsidiary or a branch of a non-domestic financial institution.
H. Practices	
For all the above conditions is there any information as whether actual practices may	There is not significant variation in the above answers by reference to the practice of the UK tax authorities. We do understand, however, that

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differ from legal provisions?	in reasonably obscure areas under the capital gains rules, a "disposal" treatment otherwise arising might be viewed in a pragmatic situation. For example, if a gain otherwise arose on the grant of an option, then there may be some degree of pragmatism in waiting to see if the underlying asset was acquired, in which case the cost of the option might be then rolled into the base cost of the asset acquired.

CHINA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. There is no tax item designed for securities transaction of financial instruments for a special purpose in China. However, generally speaking, interest income as well as capital gain derived from trading of financial instruments should be subject to 5% Business Tax ("BT") in China. BT is a kind of gross receipt tax similar to Goods and Services Tax ("GST") that is imposed on financial service income. 2. The prevailing BT regime in China has covered 4 categories of financial instruments, i.e. stocks, bonds, forex and others. For the trading of the mentioned 4 categories of financial instruments, financial institutions are allowed to net off gains and losses arising from trading of one specific category financial instrument within a calendar year for BT calculation purpose. 3. Article 3(8) and Article 3(9) of the PRC tax Circular Caishui (2003) No.16. 4. For capital gain, the losses and gains from trading of the said 4 different categories of financial instruments cannot offset against one another. However, gain and loss derived from transactions of financial instrument in the same category can be offset against on another within the same calendar yea. For interest income, it is generally taxed on gross basis. 5. The applicable BT rate is 5% for the financial service income. 6. The obligation for the payment of BT arises on the day when the taxpayer provides taxable services and receives the business income or obtains the evidence for demanding the business income, unless otherwise specified by the in-charge finance and tax departments under the State Council. 7. According to Article 4(1) of the Detailed Implementation Rules ("DIR") of BT regulation, BT should be assessed where the service recipient is located in China, or

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	where the service provider is located in China. 8. Generally speaking, it is the local tax authority governing taxpayers in different locations should collect BT. An entity or individual engaged in provision of services within the territory of China should be a taxpayer of BT.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A rswap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax?	China tax authority has not yet issued any tax guideline on taxation of swaps relating to Chinese equities regardless of whether they are traded in China or outside China. Thus the PRC corporate income tax treatment of equity swaps relating to China equities are unclear at current stage. In practice, international brokers can offer total return swaps or price return swaps relating to Chinese equities in offshore market. Relevant return swap includes, but not limited to, manufactured dividend and notional capital gain. Since all these transactions will be executed outside of China, the gain derived from total return swaps and price return swaps should technically be regarded as offshore income and not subject to China tax. We are not aware of precedent cases that Chinese tax authorities have attached any manufactured dividend or notional capital gain derived from swaps relating to Chinese equities performed wholly offshore by non-resident enterprises. Please kindly note that China is in the process of developing taxation on offshore transactions via the beneficiary ownership test. We cannot rule out the possibility that Chinese tax authority will attack these kinds of swap transactions performed wholly offshore relating to Chinese equities in the future. Some of the tax treaties with China have granted the taxation right on capital gain to foreign investor in overseas jurisdiction upon meeting certain conditions. If this is the case, if the foreign investor is a resident in a jurisdiction which has double tax treaty with China, it is theoretically

CHINA	
7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	possible for withholding income tax exemption. Nevertheless, it is important to note that, in practice, there has been no precedent successful case for any non-resident enterprise to secure treaty benefit and finally exempt 10% withholding income tax on these gains. Based on the example: ▪ Treatment of the unrealised gain of 200 for B at year end: If B is a China Tax Resident Enterprise ("TRE"), generally Corporate Income Tax ("CIT") is reported following accounting standard (i.e. on accrual basis), but the mark-to-market gain/loss could be excluded for CIT purposes whilst only realized gain/loss should be taxable/deductible for CIT purposes for certain financial products. In this regard, the unrealized gain of 200 for B at year end might be excluded from the taxable income for CIT purpose at year end. If B is a non-China TRE, since there is no actual payment at this stage, there should be no China WHT obligation for A on unrealized gain. ▪ Treatment of the payments made end of January (300 from A to B): If B is a China TRE, B is obliged to report 25% CIT on the payments received, and there should be no China tax withholding obligation for A. If B is a non-TRE in China, A should act as the China tax withholding agent when A makes the payment end of January. Generally there should be 10% withholding income tax on such payment. There might be an argument that 300 is the business profit derived by B and could be exempted for PRC tax purposes according to the relevant double-tax agreements. However, this argument is untested due to no precedent cases identified at current stage. In this situation, taxation (at the standard CIT rate of 25%) generally occurs when A makes the payment to B. The CIT rates are the same between FS and non-FS companies and there is no differentiation between CIT and capital gain tax.

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C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	It is not permissible for overseas institutions to trade directly in index future in China. In addition, the index future is not open to Qualified Foreign Institutional Investor license holder either at current stage. Therefore, the existing Chinese tax law and regulation do not have any specific guidelines on this subject, although it is envisaged that in the near future QFII may be permitted to invest in index future in China. We are not aware of precedent cases that Chinese tax authorities have attacked any non-resident enterprise on the gains derived from trading of index future performed wholly offshore. China is in the process of developing taxation on offshore transactions via beneficiary ownership test. Accordingly, we cannot rule out the possibility that Chinese tax authority will attack these kinds of future transactions performed wholly offshore in the future. Some of the tax treaties with China have granted the taxation right on capital gain to foreign investor l in overseas jurisdiction upon meeting certain conditions. If this is the case, if the foreign investor is a resident in a jurisdiction which has double tax treaty with China, it is theoretically possible for withholding income tax exemption. Nevertheless, it is important to note that, in practice, there has been no precedent successful case for any non-resident enterprise to secure treaty benefit and finally exempt 10% withholding income tax on these gains.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on	At this stage, call options on stocks traded in Chinese Stock Market is not

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any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	permissible for non-resident enterprise. For the call option relating to China equities traded outside mainland China, the gain derived from call option should technically be regarded as offshore income and not subject to China. We are not aware of precedent cases that Chinese tax authorities have attacked any non-resident enterprise on the gains derived from call options on China equities performed wholly offshore. China is in the process of developing taxation on offshore transactions via beneficiary ownership test. Accordingly, we cannot rule out the possibility that Chinese tax authority will attack these kinds of future transactions performed wholly offshore in the future.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon	Our comments are the same as those for D.

expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (lxxxvii) exercise of the options, (lxxxviii) sale of the shares acquired through the option, (lxxxix) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the	Our comments are the same as those for D.

CHINA	
asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	For tax resident enterprises in China (e.g. domestic institution, subsidiary or branch of non-domestic institution), any gains arising from trading of financial instruments should be subject to 25% corporate income tax in China. Therefore there is no differentiation.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	The PRC taxation system governing financial institution is in a state of flux and there might be inconsistencies in the application and enforcement of the PRC tax rules by different cities and provinces.

SINGAPORE	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	Very broadly, stamp duty is payable on instruments that give effect to transactions in stocks and shares. Generally, there is no stamp duty payable for derivatives instruments. Stocks are defined in the legislation to include funded debt, which is in turn defined in case law to mean debt with certain features. If a debt instrument is caught by the definition of stock, stamp duty can apply. For share transfers, the duty rate is 0.2% on the amount or value of consideration (and is payable by the buyer). That being said, share transactions carried out on the Singapore Exchange via the scrip-less settlement system do not attract duty, as there is no instrument of transfer.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain	There is no specific taxation regime for transactions in financial instruments (including swaps). ▪ Very broadly, gains and losses of a revenue nature would be assessable and deductible respectively, whereas those of a capital nature will be ignored for tax purposes, i.e. not taxable/not tax deductible.

period of time.

1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)?

2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?

3. Are the flows of payments received taxed, if yes, when and how?

4. Are the flows of payments made tax deductible, if yes, when and how?

5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax?

6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax?

7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?

The concepts of capital and revenue are drawn from UK tax law. Distinction between income and capital is often determined based on the badges of trade test (also from the UK), i.e. whether a receipt is derived in the course of a trade or business (revenue) or outside the ordinary course of business (e.g. capital appreciation from long term investment).

Gains and losses from financial instruments are *generally* of a revenue nature in the hands of financial institutions that deal in these instruments in their ordinary course of business.

- Strictly, gains will be taxed when they are realised, whereas losses will be allowed a deduction when they are incurred.

However, companies which adopt FRS 39 (the local equivalent of IFRS 39) in the preparation of their financial accounts may (subject to some exceptions) elect to report such gains and losses to tax based on the amounts reflected in the income statement.

- Swap payments by a Singapore resident or permanent establishment to non-residents may attract WHT, for example, if they are made in connection with an underlying loan or indebtedness of the payer.

Note that it is not necessarily the case that no WHT apply on equity

SINGAPORE	
	swap considering that the underlying is not a loan or indebtedness of the payer, it will depends on whether the swap is structured as a funding arrangement. If yes, then WHT will apply to payments to non-residents. Such payments may be classified as either business profits or interest, depending on the exact wording of the applicable double tax agreement. ▪ The standard corporate tax rate is 17%. There are concessions for certain Financial Sector companies which could be taxed at 5%, 10% or12%.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial	See above. 5. In practice, there is usually no WHT deducted on payments to non-residents upon expiry of (exchange-traded) futures contracts.

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Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)?	See above.

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2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xc) exercise of the options, (xci) sale of the shares acquired through the option, (xcii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied?	See above. Very broadly, the timing of recognition of gains and losses follows the accounting treatment if FRS39 tax treatment is adopted.

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6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	See above. Very broadly, the timing of recognition of gains and losses follows the accounting treatment if FRS39 tax treatment is adopted.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-	In general, no. However a Singapore branch of a non-resident company is a non-resident for tax purposes. Hence, WHT may be deducted at source

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domestic (financial) institution?	by other Singapore-based payers for certain payments made to the branch, unless it has obtained an appropriate administrative waiver from the tax authorities.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	In general, no.

SWITZERLAND	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	General: Based on our understanding no individuals are involved in the below mentioned transactions. 1. Yes; the sale or purchase of taxable securities where a Swiss security dealer is involved as a party or as an intermediary is subject to Swiss securities transfer tax. 2. For securities transfer tax purposes the following securities qualify as taxable securities: bonds, shares in a company's capital and shares in investment funds. Other securities such as options futures, etc. do not qualify as taxable securities in this regard. 3. Swiss Federal law on stamp duty 4. Besides exempt securities, there are exempt parties and exempt transactions: Exempt parties (StG 17a), e.g.: - foreign states and central banks; - domestic collective investment schemes; - foreign collective investment schemes; - foreign institutions of social security; - foreign banks and securities dealers; etc. Exempt transactions (StG 14), e.g.:

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	- the issuance of domestic shares; - the redemption of securities for cancellation; - transactions with domestic and foreign money market papers; etc. The provisions on securities transfer tax are included in the Swiss Federal law on stamp duty (StG), art. 13 et seqq. 5. The transfer stamp tax is calculated on the purchase price/remuneration of the taxable security. 6. The stamp tax is levied at a rate of 0.15% for domestic securities and 0.3% for foreign securities. The tax rate is reduced if an exempt party is either buyer or seller. There is no maximum amount of tax. 7. Transfer of a taxable security against remuneration with the involvement of a Swiss securities dealer. The connecting factor is the involvement of a Swiss security dealer in the transaction as a party or as an intermediary. Swiss securities dealers includes amongst others Swiss banks, Swiss asset managers, etc. 8. The Swiss security dealer is liable for the transfer stamp tax and needs to declare and pay his tax liability generally on a quarterly basis.
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the	1. Yes; in principal the general tax regime applies to equity Swap transactions. 2. No.

accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	3. Yes; income from equity Swap transactions is part of the annual profit of the company (to be declared with the annual tax return). 4. Yes; expenses from equity Swap transactions are part of the annual profit of the company (to be declared with the annual tax return). 5. No Swiss WHT is levied on swap payments to non-residents (provided that the transaction is not considered as tax evasion). 6. No. 7. The payments in question 5 and 6 should generally fall under the provision of capital gain based on Swiss double tax treaties. In principle, the classification does not depend on the nature of the underlying.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial	1. Yes; in principal the general tax regime applies to financial futures. 2. No. 3. Yes; gains and losses from transactions with financial futures are part of the annual profit of the company (to be declared with the annual tax return). 4. There is no need to apply mark-to-market valuation, Swiss GAAP in principle does

future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how? 4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	not follow the true and fair view approach (in case the instrument is booked in the trading book, mark-to-market valuation may be applied. Based on Swiss GAAP the acquisition price (initial book value) is principally equal to the fair market value at acquisition date. Depreciation on the initial book value is possible if the fair market value decreases, resulting in a new (lower) book value. If the market value increases again, the book value can be increased up to the initial acquisition costs. If the market value is above the initial costs then it depends whether the instruments are treated as trading book or investment book; in case of investment book, the book value cannot be higher then initial costs; in case of trading book, the book value can be increased up to the fair market value. This treatment does apply for all Swiss companies (i.e. in the financial and non-Financial Sector). Expenses and income is reported and taxed whenever it is recognised in the P&L. 5. No. 6. No. 7. The payments in question 5 and 6 should generally fall under the provision of capital gain based on Swiss double tax treaties. In principle, the classification does not depend on the nature of the underlying.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover	1. Yes; the general tax regime applies to call options on stocks.

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the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	2. No. Please note that the exercise of the call option, i.e. the subsequent purchase of the underlying share is subject to Swiss transfer stamp tax if a Swiss security dealer is involved.
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?	1. Principally, the premium paid is tax deductible as part of the annual profit (to be declared with the annual tax return), i.e. in case of a value adjustment (incl. expiration). 2. No. 3. In principle yes. Note that Answers to 1 and 3 are not contradictory as the deductibility arises in case of a value adjustment of the capitalised options. If no value adjustment is required during the term, the premium is part of the acquisition price. 4. (i) Any capital gain or loss is taxable/tax deductible.

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2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xciii) exercise of the options, (xciv)sale of the shares acquired through the option, (xcv) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	(ii) In principle no taxable event (profit may be taxed only if company realises a gain through the exercise and the shares are recorded in the trading books). (iii) Any capital gain or loss is taxable/tax deductible. Capital gain would be subject to the participation relief if the participation sold exceeds 10% and a minimal holding period of one year is met; (iv) No taxable event. Usually, the premium is tax deductible any time when the value of the options needs to be adjusted. If that did not happen during the term of the option, the premium is deductible at expiration. 5. There is no need to apply mark-to-market; Swiss GAAP does not follow the true and fair view approach. 6. No. 7. The payments in question 6 should generally fall under the provision of capital gain based on Swiss double tax treaties. In principle, the classification does not depend on the nature of the underlying. 8. If the option is part of a structured product (packaged product) but can clearly be separated from the "non-option" part of the product the same tax treatment should apply. Please note that the exercise of an option, i.e. the subsequent purchase of the underlying share is subject to Swiss transfer stamp tax if a Swiss security dealer is involved.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the	1. The tax treatment of the premium in principle depends on the accounting treatment; whenever the premium is recognised in the P&L as income, it is taxable. Usually, the premium is not booked through P&L at the grant of the options but is

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applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	deferred; income may arise if the deferral can be value adjusted or if the option expires). 2. No. 3. In principle yes. 4. Yes; gains and losses are taxable/tax deductible. 5. There is no need to apply mark-to-market; Swiss GAAP does not follow the true and fair view approach. Please note that the exercise of an option, i.e. the subsequent purchase of the underlying share is subject to Swiss transfer stamp tax if a Swiss security dealer is involved.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	No, principally not. However, as branches of a foreign head office are not subject to Swiss WHT, no Swiss WHT consequences would apply (although the products as outlined above should not trigger Swiss WHT consequences at all).

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H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	We are not aware of any differences between the actual practices of the Swiss tax authorities and the legal provisions. Note in this respect that the Swiss tax treatment follows the Swiss accounting treatment according to Swiss GAAP. Compared to other accounting standards as IFRS or US GAAP, Swiss GAAP provides a lot of flexibility and has a few strict rules only. Hence, there is usually more than one way to appropriately reflect a transaction in the financial statements, although slightly stricter rules apply for financial services industry.

THE UNITED STATES OF AMERICA	
A. Securities transaction taxes	
Securities transaction tax is a tax placed on a specific type (or types) of financial transaction for a specific purpose. Capital duty tax or capital registration tax (tax imposed on increases in business capital in the form of capital contribution, loans and/or issuance of stocks or bonds) are not in scope of this question. 1. Are there securities transactions taxes on transfers of financial instruments? 2. What securities are in scope and which are exempt? 3. What are the tax provisions (reference to applicable tax section)? 4. Tax base? 5. Tax rate? Is there a maximum amount of tax due? 6. Tax event? 7. What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)? 8. Who is liable for levying the tax? Who is liable to support the tax?	1. No Federal securities transaction tax. 2. All others: n/a
B. Corporate income tax treatment of equity Swaps	
This question does not cover the accounting treatment of swaps, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment. (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.) This question does not cover the applicable tax treatment of the underlying securities. Only equity swaps are covered. A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. 1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both	1. Specific rules apply 2. Sometimes, yes. 3. Yes. Sometimes on an accrual basis. Sometimes on an amortization basis (e.g., for upfront payments). Sometimes mark to market accounting trumps accrual of periodic cash flows. These rules are very complicated. 4. Generally yes. See above re: timing. There are exceptions to

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parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are the flows of payments received taxed, if yes, when and how? 4. Are the flows of payments made tax deductible, if yes, when and how? 5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	deductibility. 5. Generally no. Exceptions exist (e.g., where a "significant non-periodic payment" is made or received, or in some cases, where the referenced asset is equity of a US corporation). 6. Generally swaps cannot be "sold." When a swap is terminated, there typically is no non-resident withholding. We assume your question refers to early termination. 7. Unclear under US law. Likely as other income.
C. Corporate income tax treatment of Financial Futures	
This question does not cover the accounting treatment of futures, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short term interest rate. 1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector? 3. Are gains and losses taxed, and if yes, when and how?	1. Futures contracts traded or regulated US exchanges and certain foreign exchanges are subject to special rules. Nb: these rules do not apply to off-exchange forward contracts. 2. Generally no. However, there may be a difference if a futures contract is used as a hedging transaction as opposed to a speculative transaction. 3. Yes. Frequently on a mark to market basis though exceptions may apply. Generally, character is a 60/40 split between long-term and short-term capital gain. Exceptions exist. 4. See above. Frequently yes. 5. Generally no.

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4. Is mark-to-market applied? 5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax? 7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain,…)? Does the classification depend on the nature of the underlying?	6. Futures contracts typically are not "sold" but rather are extinguished by an exchange clearinghouse. Generally no WHT. 7. Gain from the sale of personal property.
D. Corporate income tax treatment of Call options on stocks in general	
This question only concerns call stock options not put options, nor options on any other financial or non financial instruments. This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. A call option on stock is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder) which gives the option buyer the right but not the obligation to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price). 1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stocks transactions (where both parties are companies in the Financial Sector)? 2. Is there a difference if one or both of the counterparties are companies in the non Financial Sector?	1. Special rules apply. 2. Sometimes yes (e.g., where the taxpayer is a dealer v. a non-dealer for US tax purposes).
E. Corporate income tax treatment of Call options on stocks in the hands of the holders	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments).This question does not cover the accounting treatment	1. Generally offset against cash settlement gains (if any). Physical

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of call options on stocks, although reference to the applicable accounting treatment should be made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The holder of a call option on stocks is the option buyer. 1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how? 2. Is there a difference if the holder is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium paid part of the stock acquisition price? 4. Please describe the tax treatment of the gains or losses realised at the following events: (i) disposal of the options, (xcvi)exercise of the options, (xcvii) sale of the shares acquired through the option, (xcviii) expiration of option (without exercise or disposal) 5. Is mark-to-market applied? 6. Is there a WHT on premium to non-residents? 7. How are the premium payments classified under the double tax treaties? 8. How are options treated when they are part of a packaged product (e.g. equity linked note)?	settlement triggers an addition of call premium to stock basis. 2. Possibly -- dealers in securities typically have to apply mark to market accounting to options, potentially accelerating basis recovery. 3. See above - yes, where physically settled. 4. (i) Taxable. Capital gain/loss to most holders. Generally ordinary income/expense to hedgers and to dealers. (ii) Cash settlement triggers tax. Physical settlement triggers addition of call premium to stock basis. See above. (iii) Taxable. See above re: basis considerations. (iv) Taxable. Generally triggers deduction of call premium as capital loss. Different rules may apply depending on taxpayer classification (e.g., dealer v. hedger v. speculator). 5. Sometimes. 6. Generally no. 7. Generally irrelevant. 8. Depends on terms of the packaged product.
F. Corporate income tax treatment of Call options on stocks in the hands of the writers	
This question only concerns call stock options (not put options, nor options on any other financial or non financial instruments). This question does not cover the accounting treatment of call options on stocks, although reference to the applicable accounting treatment should be	1. Yes, upon lapse or cash settlement. If physically settled, premium is added to amount realized.

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made if this is relevant to understand the tax treatment (Very often the CIT would follow the accounting rules, so any specifics in the accounting treatment would have equal impact on the tax treatment.). This question does not cover the applicable tax treatment of the underlying securities. Physical settlements are covered. The writer of a call option on stocks is the option seller, who has the obligation to make the asset available at strike price. 1. For writers, is the premium received taxable, and if yes, when and how? 2. Is there a difference if the writer is a bank/insurance company or a company active in the non Financial Sector? 3. Is the premium received part of stock delivery price? 4. Are gains and losses upon exercise taxed? 5. Is mark-to-market applied?	2. Sometimes yes. See above re: dealer v. hedger v. speculator distinction. 3. When physically settled, generally yes. 4. Generally yes. 5. Sometimes.
G. Differentiation	
For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?	Possibly. Depends on activities domestic corporation or foreign corporation. Branches of foreign financial institutions are subject to complicated rules regarding income inclusion and availability of certain deductions.
H. Practices	
For all the above conditions is there any information as whether actual practices may differ from legal provisions?	Transaction form is sometimes less relevant than the economic substance of a transaction under review. Case-specific application of the general principles above is important.

ENCLOSURE 23: ADDITIONAL QUESTIONNAIRE ON TAXATION OF FINANCIAL INSTRUMENTS

The following additional questions were asked on 18 May 2011 by the European Commission in the framework of the review of the interim report:

We would just like to double check whether specific accounting rules for financial institutions and/or banks (maybe only if these are listed) apply in certain Member States that have reported that no specific tax rules exist for income arising from financial instruments earned by financial institutions (more particularly, Germany, the Netherlands, Poland, Latvia and Lithuania).

We just need to know whether specific accounting rules for the Financial Sector may potentially lead to a different tax treatment of the instruments, even if it is only a matter of timing in recognition of gains and losses. A one-line response (almost yes or no) would suffice, we understand that there is no time to go into the details of every instrument.

On that basis, the following questionnaire has been sent to our colleagues in the various jurisdictions:

We understand from the answers received in the questionnaires that in the majority of the countries in scope of the study no specific tax rules exist for income arising from financial instruments earned by financial institutions so that the general tax regime should, as a rule, apply (see questions B.1; C.1 and D.1 of the initial questionnaire). The questions below relate to the potential impact which a difference in accounting rules, if any, could have on the tax treatment of a financial instrument.

1. Specific accounting rules :

1.1. Could you please inform us whether specific accounting rules for (some) financial institutions and/or banks apply in your country? YES / NO

1.2. If YES, do these rules apply only if these financial institutions are listed? YES / NO

2. If there are specific accounting rules for financial institutions and/or banks (i.e. if YES at 1.1 above);

2.1. Could you please indicate whether these specific accounting rules for the Financial Sector may potentially lead to a different tax treatment of the instruments? YES / NO

2.2. If YES, would these specific accounting rules lead to a difference of the timing in recognition of profits and losses, or would there be other differences in tax treatment due to the specific accounting rules?

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
AUSTRIA	YES (basically all regulated financial institutions have their own accounting framework under Austrian GAAP, based on which the corporate income tax is computed)	NO	YES (the corporate income tax being based on the Austrian GAAP framework applicable, differences between the accounting rules applicable might potentially lead to differences in the tax treatment of the instruments)	Basically differences of timing
BELGIUM	YES (basically all regulated financial institutions have their own accounting framework under Belgian GAAP, based on which the corporate income tax is computed)	NO	YES (the corporate income tax being based on the Belgian GAAP framework applicable, differences between the accounting rules applicable might potentially lead to differences in the tax treatment of the instruments)	Differences of timing
BULGARIA	NO, Banks in Bulgaria apply the general IFRS rules.	NO, the IFRS rules apply for all banks.	NO	NO, the IFRS rules do not lead to difference of timing in recognition of profits and losses. However, such may arise under the tax legislation (e.g. banks are allowed to recognise profits/losses arising from revaluation of financial assets in the year of accrual instead of forming a temporary tax difference under the general rules).

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
CYPRUS	NO, the Banks (as all companies that are tax resident in Cyprus) are required to prepare financial statements in accordance with IFRS as adopted by the European Union and the requirements of the Cyprus Companies Law.	N/A	N/A. The taxable income is computed on the basis of IFRS results as adjusted in accordance with provisions of Cyprus income tax law.	N/A
CZECH REPUBLIC	YES, all banks have special chart of accounts	N/A	NO, as principles are the same as for enterpreneurs	N/A
DENMARK	Danish banks have their own Act. The material rules hereof follow IFRS to a very large extent. Therefore, no specific material accounting rules exist for Danish banks.	N/A	In our view, our answer to 1.1 is NO and therefore no comment is needed to this question. However, it should be mentioned that the tax and accounting treatment of financial instruments under Danish accounting rules (as described above) and Danish tax rules may differ.	
ESTONIA	NO, as there are no specific accounting rules for financial institutions and banks. However, all financial institutions (except leasing companies) and banks are required to prepare their financial statements in accordance with IFRS. Other companies (if unlisted) may prepare their financial statements either in accordance with local GAAP or IFRS.	NO	NO	N/A

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
FINLAND	YES (basically all regulated financial institutions have their own accounting framework under specific Finnish GAAP, authorities regulations or IFRS standards).	NO	NO (based on high level discussions there should be no such specific rules which would lead to a different tax treatment of the instruments)	YES (the differences of timing)
FRANCE	YES	NO	YES	YES they would lead mainly to a difference of timing
GERMANY	YES (There are some specific accounting rules in place for banks and financial institutions e.g. with regard to the valuation of financial instruments and with regard to accounting reserves for general risks of the banking business)	NO	YES (The tax treatment might differ from the specific accounting rules e.g. the accounting reserves for general risks of the banking business are disregarded for taxation purposes)	Differences of timing
GREECE	No. Listed companies, Banks and financial institutions prepare their financial statements under IFRS. Other companies (including insurance companies) may elect to apply IFRS or Greek GAAP (note: specific accounting rules apply to insurance companies under Greek GAAP).		Companies preparing their financial statements under IFRS adjust their accounting result for tax purposes through the preparation of an "Accounting and Tax Base Reconciliation Table". Difference of the timing in recognition of profits and losses between tax provisions and IFRS are eliminated for tax purposes in the "Accounting and Tax Base Reconciliation Table".	

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
HUNGARY	YES	NO	In certain specific cases difference in the accounting treatment is possible which might lead to different tax treatment.	An example for such a potential difference may be the accounting treatment of non-hedge derivative transactions, where - in the case of expected losses of non-closed transactions - banks might be able to offset such expected losses with expected gains on other similar transactions (we referred to this earlier as "quasi hedge transactions"), and hence be exempted from the obligation to create provisions (i.e. account expenses) for such losses [Section 23.7 of Decree 250/2000 of the Government]. On the other hand, non-FS companies would have to account for accrued expenses [Section 44.5 of Act C of 2000 on Accounting], resulting in a decreased corporate income tax base.
IRELAND	NO			

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
ITALY	YES. Broadly speaking financial institutions prepare their annual accounts according to IAS/IFRS principles. Nevertheless there are some exceptions to this rule; in fact, some financial entities (i.e. insurance companies) apply the Italian GAAP. Moreover, all kinds of regulated financial institutions (i.e. banks, management companies, insurance companies, etc.) have their own accounting framework provided by the relevant authority (i.e. Bank of Italy). Corporate income taxes are computed on the annual accounts.	NO	YES (differences between accounting rules - in particular differences between Italian GAAP and IAS principles - might potentially lead to differences in the tax treatment of the instruments).	Both
LATVIA	NO (all regulated financial institutions apply IFRS as adopted for EU based on which the corporate income tax is computed)	NO	NO	NO (same as for other sectors, only realised gains/ losses are taxable/ deductible - please see our previous answers for details of taxation of gains/ losses on shares/ other assets in Latvia)
LITHUANIA	NO (Financial institutions should use IFRS)	N/A	N/A (please note, however, that there could be some differncences in tax treatement for financial institutions but these are related to specific tax (ant not accounting) rules)	N/A

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
LUXEMBOURG	Yes, regulated financial institutions could apply Luxembourg GAAP with some specific provisions foreseen by the banking law or IFRS. Accounting serve as the basis for the computation of corporation taxes in "Luxembourg according to article 40 of the Luxembourg Income Tax Law.	NO	Potentially yes (to be analyzed on a case-by-case basis) as taxes are computed based on accounting. However, in case of difference between accounting and tax rules, tax rules should prevail. In this respect, the luxembourg tax legislation provides for some specific valuation rules (art. 23 LITL) so that a different accounting treatment may not necessarily result in a different tax treatment between a financial institution and any taxpayer.	Potentially timing but may be adjusted due to tax valuation rules.
MALTA	The default accounting framework in Malta for financial reporting is IFRSs as adopted by the EU. Although companies that meet certain qualitative and quantitative criteria may voluntarily choose to adopt Maltese GAAP ("GAPSE") as their accounting framework, GAPSE cannot be adopted by entities that hold an operating licence which was granted by the Malta Financial Services Authority (such as banks and financial institutions). Hence banks and financial institutions are required to follow IFRSs as adopted by the EU.	N/A	N/A	N/A

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
NETHERLANDS	In the Netherlands banks and other financial institutions mostly use "IFRS as endorsed by the EU", and in some instances Dutch GAAP. There are no specific accounting rules for banks and financial institutions included in IFRS or GAAP, however there are certain accounting rules that have more impact on banks than other companies and thus banks primarily focus on these rules.	NO	NO	NO
POLAND	YES (e.g. specific accounting rules for provisions for bad debts in banks)	NO	NO	N/A
PORTUGAL	YES	NO	NO, since the accounting rules (in what concerns to financial instruments) for the Financial Sector and other sectors are the same (both follow IAS/IFRS).	N/A

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
ROMANIA	YES, there are specific accounting rules provided by the National Bank of Romania, which are in accordance with the European Directives, that are applicable for financial institutions such as: banks (i.e. credit institutions) and non-banking financial institutions (e.g. leasing companies, consumer finance companies,etc.). Also, please note that starting from 2012, banks will be required to implement and apply IFRS.	NO, these regulations apply irrespective of the listed or non-listed status of an entity.	YES, For banks and some other financial institutions, gains or losses on revaluation of certain types of derivative financial instruments would be recognised periodically in the accounting records. Since the tax would generally follow the accounting, and some of these income/loss items would not be recorded by regular companies until realised, there would in effect be a difference in the tax treatment.	It would typically be a timing difference
SLOVAKIA	YES (Financial instutions and companies meeting specific conditions prepare their financial statements under IFRS)	NO	NO	N/A

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
SLOVENIA	Banks and insurance companies have to prepare their financial statements under IFRS, so Slovene GAAP does not affect how they account for income from financial instruments. They have to prepare their financial statements under a format specified in the Banking and Insurance laws, but this is mainly a matter of disclosure. Other financial institutions can generally choose whether to account under IFRS or under Slovene GAAP. The main difference between IFRS and Slovenian GAAP concerns impairment of assets held for sale. However, this applies generally and is not specific to financial institutions.		The accounting principles used for banks and insurance companies are those under IFRS, so it is unlikely that this would lead to any differences in taxation.	
SPAIN	YES (basically all regulated financial institutions have their own accounting framework under Spanish GAAP, based on which the corporate income tax is computed)	NO	YES (the corporate income tax being based on the Spanish GAAP framework applicable, differences between the accounting rules applicable might potentially lead to differences in the tax treatment of the instruments)	Differences of timing

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
SWEDEN	YES (basically all regulated financial institutions have their own accounting framework under Swedish GAAP, based on which the corporate income tax is computed)	NO	YES (the corporate income tax being based on the Swedish GAAP framework applicable, differences between the accounting rules applicable might potentially lead to differences in the tax treatment of the instruments in comparison to non-financial companies)	Differences of timing
UK	No - all listed groups are required to apply EU endorsed IFRS - as such there are differences in application for financial traders vs. corporates who hold bonds, shares etc. on capital account, but it is the same set of rules which apply. Unlisted UK groups may apply either IFRS or UK GAAP (which is substantially similar).	N/A (see 1.1.)	N/A	N/A
CHINA				

Country	1.1 Specific accounting rules for (some) financial institutions and/or banks? YES / NO	1.2 Only if these financial institutions are listed? YES / NO	2.1 Specific accounting rules which may potentially lead to a different tax treatment of the instruments? YES / NO	2.2 Difference of the timing in recognition of profits and losses, or other differences in tax treatment?
SINGAPORE	Singapore's accounting standards are modelled after IFRS. As IFRS are issued based on subjects/ transactions and not industries, they should apply to all companies including banks.	NO	In very general terms, accounting treatment should not dictate the tax treatment. However, in some instances they may affect the timing of recognition of gains and losses for tax purposes, eg when a taxpayer elects to follow FRS 39 for tax reporting. There may be other exceptions too, eg operating v finance lease, and it is not possible to state all of them in a short note.	See 2.1.
SWITZERLAND	YES	NO	Yes (due to different accounting treatment)	Yes, difference of the timing
USA				

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Comparison of Different Compensation Components and Levels Among Different Sectors of the Economy - Ares(2011) 550517

Peter H. Egger
ETH Zurich

Maximilian von Ehrlich
ETH Zurich

Doina Radulescu
ETH Zurich

May 27, 2011

Abstract

This paper provides an assessment of the extent of managerial pay around the world. It uses a novel database on managerial wages and other forms of compensation to compare managerial remuneration across different sectors with a special emphasis on the financial sector versus other sectors, and it does so by comparing different countries with each other. We find that there is a significant earnings premium in the financial sector which amounts for the overall sample (including both EU and Non-EU countries) to about 40 percent after conditioning out observable director-specific and firm-specific characteristics. Yet, there is considerable heterogeneity of earnings across different types of businesses within the financial sector.

Keywords: Managerial pay; Financial Sector; Banks; EU
JEL classification: G2; J24; J3; O51; O52

1. INTRODUCTION

At least with the economic crisis of 2008 – the roots of which are inter alia seen in the lack of regulation of and misconduct by agents in the financial sector – executive compensation, especially in the financial sector, has become a contentious issue. Recently, the Wall Street Journal published the results of the annual study on Chief Executive Officers' (CEO) compensation for the biggest 350 public companies in the United States conducted by the Hay Group (Wall Street Journal, 2011). According to this study, the median value of CEO pay including salary, long term incentive plans, and bonuses increased by 11 percent to 9.3mn US dollars between 2009 and 2010. The bulk of this surge is attributed to a significant rise in bonuses by 19.7 percent, induced by an increase in profits. The top ranks in terms of pay in this list of CEOs are held by CEOs of media companies. However, when averaging within industries, the study suggests that chief executives in the telecom, oil and gas, consumer goods, and financial sectors received higher pay on average than their counterparts elsewhere. In any case, the Hay Group study gives an impression of the magnitude of compensation in different industries as well as the extent of existing disparities.

In the light of the recent financial crisis, many questions have been raised regarding both the appropriateness of the *level* of compensation as well as the *structure of incentives* of directors and managers employed in the financial sector. Several European institutions, the International Monetary Fund (IMF), the group of G-20 countries, and the European Union (EU) member states have had a number of policy debates concerning whether tax systems should be adapted to make the financial sector contribute in a fair and substantial way to public budgets (see IMF, 2010, and European Commission, 2010). This ongoing debate is fueled by questions such as whether the sector is too big in general and behaves too risky due to high concentration in the industry, the availability of implicit state guarantees, and the value added tax exemption of many financial services. Both academics and policy makers are concerned that these features could lead to economic rents which among others translate into higher wage payments compared to representatives with similar qualifications in other sectors. Already in 2009, for instance, the Obama administration was concerned about finding ways of changing compensation practices at firms in the financial industry in a way that would better align pay with long-term performance. This concern rooted in the observation of the high extent of variable compensation (such as bonus payments) which is linked to the short-term performance of a company instead of focusing on incentives aimed at raising and stabilizing the long-run value of firms. However, this particular focus on the regulation of the banking sector only has been criticized: employees could choose to work in non-regulated areas of

the financial sector such as private equity firms, or hedge funds (Wall Street Journal, 2009) so that the problem would be shifted to other players rather than being eliminated at large.

With a view on these discussions, the present paper aims to shed light on the issue of executive compensation of directors employed in the financial sector and quantify the extent of the premium of their pay relative to directors and CEOs with similar characteristics employed in other sectors of the economy. To be able to identify such a premium, we aim at addressing the following questions in this study. Does the financial sector pay better because the employees have special skills or are better educated than in other sectors? Obviously, answering such a question requires data on CEOs and directors with some information about their characteristics such as education and experience. If the answer to that question were yes, the premium in pay would simply be a skill premium and the matter one of self-selection of the best-educated individuals into the financial sector. Is there a premium in pay for financial sector at large or is it a matter of only some subsectors such as investment banking? An answer to that question can only be given from a data-set which covers sectors beyond the financial industry. Is the premium in the financial industry very much a phenomenon arising in a few countries such as the United States and United Kingdom or is it a global phenomenon? Obviously, the latter could not be addressed by a large number of studies utilizing data from only a single country such as the United States. Is the premium only a matter for CEOs or also for other executive directors?

The paper remainder of the paper is organized as follows. The subsequent section provides an overview of the literature on compensation of financial sector employees. In Section 3, we present report on a relatively novel data-set our study is based upon and provide some descriptive statistics. Section 4 introduces the estimation strategy and summarizes related empirical results. The last section concludes with a synopsis of the key findings.

2. LITERATURE

Previous work on the level and structure of CEO compensation has focused almost entirely on the United States especially due to the availability of the relevant data for that country. For instance, using data from Frydman and Saks (2010), Frydman and Jenter (2010) portray the evolution of total compensation for executives in the 50 largest firms between 1936 to 2005. The growth in CEO pay gained pace in around 1975, reaching its peak at the end of the 1990s with the Dot-Com bubble. The authors document a tremendous increase in compensation during the 1990s, where the median level of CEO pay among the S&P 500 companies rose from 2.3mn

US$ in 1992 to as much as 7.2mn US$ in 2001. Their findings suggest that firm size does not only explain *compensation levels* but also *pay raises*. Regarding the structure of executive compensation, the mentioned studies document a change in the relative importance of different compensation components such as salary, bonuses, and options over time. Until the 1970s, monetary incentives focused on bonuses based on annual accounting performance, and long-term incentive plans linked to multi-year performance. These features started to change in the early 1980s. In order to incentivize directors to focus on shareholder value, firms started awarding stock options which are tied to the evolution of share prices then. This type of compensation gained in importance especially in the 1990s and it formed up to 47 percent of total compensation in 2002 in the United States. Nowadays, it is the main component of CEO pay. Hence, the tremendous increase in executive compensation in the last decade can be largely attributed to the boost in stock option compensation. Similar trends of huge increases in executive compensation in the United States are also documented in a number of other studies such as Bebchuk and Grinstein (2005) or Gabaix and Landier (2008) to name but a few recent examples. None of the aforementioned papers considered compensation levels or schemes outside of the United States. One exception is a working paper by Fernandes, Ferreira, Matos, and Murphy (2010) which tries to explain the differences between the compensation of US executives and their counterparts in other economies. Their findings confirm our results that directors in the United States receive significantly higher remuneration and their pay is much more performance sensitive in the sense that the fraction of variable compensation in terms of options and shares is higher than in non-US countries.

However, all the above mentioned studies, do not consider the compensation of executives in the financial sector in particular, but look at the whole economy and sometimes control for specific sectors by using industry fixed effects. Only a rather small number of papers focuses on the compensation of employees in the financial sector vis-à-vis their counterparts in other sectors and employ US data only. The paper closest to other, by Philippon and Reshef (2009), identifies the existence of economic rents in the financial sector which can explain 30 percent to 50 percent of the wage differential. The authors use detailed data on wages in the US financial sector between 1930 and 2006 to provide evidence that these reached excessively high levels especially around 1930 and between 1995 to 2006. Their results suggest that on the one hand, complex corporate activities such as IPOs or credit risk have a positive effect on the demand for skilled workers whereas on the other hand, stricter regulation has a negative effect on the demand for skilled workers. In contrast to Philippon and Reshef (2009) who use population survey data, we focus explicitly on directors in our study. Regulation, or rather deregulation of the financial sector and its effects on executive pay is also the subject of the paper by Cuñat and

Guadalupe (2009). In their article, the authors use as quasi natural experiments two deregulation episodes in the US banking and financial industry in the 1990s to study their effect on executive pay. Their findings indicate that while deregulation and accordingly increased competition led to an increase in the performance pay sensitivity and accordingly in variable pay, fixed and effort independent pay declined.

3. CROSS-INDUSTRY AND CROSS-COUNTRY DATA ON MANAGERIAL COMPENSATION

The main data-set we employ in this study is BoardEx, compiled by Management Diagnostics Limited. The data-set offers detailed compensation data such as ones on salary, bonuses, long-term insurance plans (LTIPs), or estimated value of options awarded as well as biographic information (age, education, gender, etc.) on directors and officers in 42 countries. In total, the BoardEx data-set we utilize covers 24,508 directors and 7,403 companies for the time period 1998-2008.

We exclude data prior to 2002 and after 2007 for two main reasons. First, the country and industry coverage is much better from 2002 onwards with data coverage being skewed strongly towards the United States prior to that. Second, including years at the time of the bursting of the Dot-com market bubble in 2001 or the peak of the financial crisis in 2008 might bias the results. Furthermore, we drop independent directors from the sample as we are only interested in those executives who are company employees and accordingly receive both fixed and variable remuneration for their work in these firms. Given these considerations, we may use data on bonuses for 13,173 directors and 4,022 companies, on salary for 13,467 directors and 4,040 companies and on total compensation for 12,492 directors and 3,841 companies. We merge this data-set based on BoardEx onto data from Compustat which provides detailed firm characteristics, such as the number of employees or the return on assets, variables which we will use as control variables in our regressions which we employ to identify observable determinants of executive pay.

The companies covered can be grouped according to the Global Industry Classification Standard (GICS) into four major sectors, namely finance (GICS group 40), industry (GICS group 20), consumer goods (GICS groups 25 and 30), and others where the latter include inter alia the information technology sector, the pharmaceutical and chemical industry, etc. (GICS groups 10, 15, 35, 45, 50 and 55). Focusing on the financial sector, we can assign the companies into four subsectors, namely commercial banks, real estate, insurance and other finance (the last subsector including basically investment banks and capital market firms). This subdivision allows us to identify compensation differences within the financial sector.

4. EMPIRICAL EVALUATION

Let us start looking at various remuneration components in selected industries and countries by way of descriptive statistics. In particular, let us illustrate average compensation components and provide some other moments of those before turning to estimating the determinants of compensation premia in the financial sector and consider the conditional differences in compensation across sectors.

4.1 COMPENSATION BY SECTORS, COUNTRIES, AND ROLES

Table 1 provides summary statistics on the total level of compensation as well as its components for the overall sample and for the four different sectors mentioned above. Regarding the coverage of the different sectors notice the following. There is an overall number of 42,447 observations regarding total compensation of which the industrial, the consumer goods, the financial, and the other sectors account for 7,757, 10,812, 7,969, and 15,909, respectively. Hence, around 19 percent of the observations on total compensation accrue to directors in the financial sector. The coverage is similar for other remuneration components such as bonuses, LTIPs, salary and options.

Even a first glance at the numbers shows that executives in the finance industry at large tend to receive a higher pay on average – especially in terms of total compensation, bonuses, and LTIPs – than their counterparts in other sectors of the economy. The average value of total compensation reaches 2.8 mn US$ and is thus 9.8 percent lower than in the financial sector where the average is around 3.2 mn US$. Executives in the industrial sector receive only around 2,1 mn US$ on average. The difference is even more striking when it comes to bonuses and LTIPs which amount on average to 1.8 mn US$ in the financial sector and are thus by 30 percent higher than on average. Following the numbers presented in Table 1, we should also notice that the share of variable compensation – defined as the sum of bonuses, LTIPs, and the estimated value of options awarded divided by total compensation – is with 52.5 percent the highest in the financial sector which seems to indicate that pay is much more performance-sensitive than in other sectors.

Table 2 distinguishes once again between the different compensation components, yet not between different sectors but for different roles, namely CEOs and Non-CEOs. We use the term CEO for chief executives, irrespective of whether the company denotes this role as *CEO*, *chief executive*, *managing director*, or *president/CEO* in its reports. As expected, the values reported in Table 2 are significantly higher for CEOs than for Non-CEOs for both overall compensation and its components. CEOs receive an average annual total compensation of 4.3 mn US$ which represents 2.8 times the average compensation of Non-CEOs. The contrast is

most striking for options where the value awarded to CEOs is more than 4 times the one of Non-CEOs. Once again, the numbers presented for the share of variable compensation in total compensation indicate that the reliance on performance-related pay is more important for CEOs than for Non-CEOs.

Table 1: COMPENSATION COMPONENTS BY SECTOR

	Mean	Std.dev.	Min	Max	Observations
	(1)	(2)	(3)	(4)	(5)
Total Compensation (1000$)					
Total	2,838.78	7,574.18	1	437,760.00	42,447
Industry	2,131.35	6,716.04	1	326,989.00	7,757
Consumer goods	3,019.42	7,636.77	1	289,496.00	10,812
Finance	3,146.50	7,049.34	2	158,048.00	7,969
Other	2,906.79	8,138.61	2	437,760.00	15,909
Salary (1000$)					
Total	509.69	532.44	1	64,517.00	42,438
Industry	486.37	396.24	1	6,522.00	7,757
Consumer goods	580.35	791.20	1	64,517.00	10,808
Finance	523.98	431.41	1	7,002.00	7,964
Other	465.91	394.49	1	7,620.00	15,909
Bonus and LTIPs (1000$)					
Total	1,430.75	5,458.32	0	418,031.00	40,190
Industry	1,149.31	5,902.11	0	321,743.00	7,334
Consumer goods	1,490.82	5,490.74	0	288,462.00	10,237
Finance	1,870.24	5,191.21	0	122,600.00	7,570
Other	1,305.97	5,327.09	0	418,031.00	15,049
Options (1000$)					
Total	978.30	4,051.16	0	208,102.00	39,693
Industry	565.01	2,401.36	0	92,936.00	7,118
Consumer goods	1,022.04	4,425.68	0	208,102.00	10,129
Finance	863.36	3,641.55	0	149,587.00	7,420
Other	1,201.36	4,553.56	0	186,449.00	15,026
Variable compensation as share of total compensation (percent)					
Total	49.09	32.33	0	99.95	42,438
Industry	45.70	30.01	0	99.75	7,757
Consumer goods	48.03	32.07	0	99.93	10,808
Finance	52.51	32.25	0	99.95	7,964
Other	49.75	33.42	0	99.93	15,909

Notes: We restrict our sample to executive directors and to the 2002-2007 period. Total compensation is defined as the sum of salary, boni, estimated values of options awarded and the value of long-term incentive plans. The value of options is calculated according to the Black-Scholes model. The sector classifications refer to the Global Industry Classification Standard (GICS) where industry refers to GICS group 20, consumer goods to groups 25, 30, finance to group 40, and others to the remainder.

Table 2: COMPENSATION COMPONENTS BY ROLE

	Mean	Std.dev.	Min	Max	Observations
	(1)	(2)	(3)	(4)	(5)
Total Compensation (1000$)					
Non CEOs	1,574.30	3,967.00	1	208,824.00	23,107
CEOs	4,349.54	10,144.88	1	437,760.00	19,340
Salary (1000$)					
Non CEOs	398.66	364.14	1	8,320.00	23,099
CEOs	642.32	656.84	1	64,517.00	19,339
Bonus and LTIPs (1000$)					
Non CEOs	840.73	3,102.77	0	204,,193.00	21,944
CEOs	2,140.35	7,288.76	0	418031.00	18,246
Options (1000$)					
Non CEOs	383.71	1,958.96	0	70,007.00	21,296
CEOs	1,666.60	5,485.03	0	208,102.00	18,397
Variable compensation as share of total compensation (percent)					
Non CEOs	43.71	30.81	0	99.92	23,099
CEOs	55.51	32.93	0	99.95	19,339

Notes: We restrict our sample to executive directors and to the 2002-2007 period. Total compensation is defined as the sum of salary, boni, estimated values of options awarded and the value of long-term incentive plans. The value of options is calculated according to the Black-Scholes model. We define CEO as the leading role in the board of directors which is ambiguously phrased in the Boardex dataset.

While the tables just described provide some information about the structure and level of CEO pay in different industries without distinguishing among different countries, we consider the latter aspect as well in the following graphs.

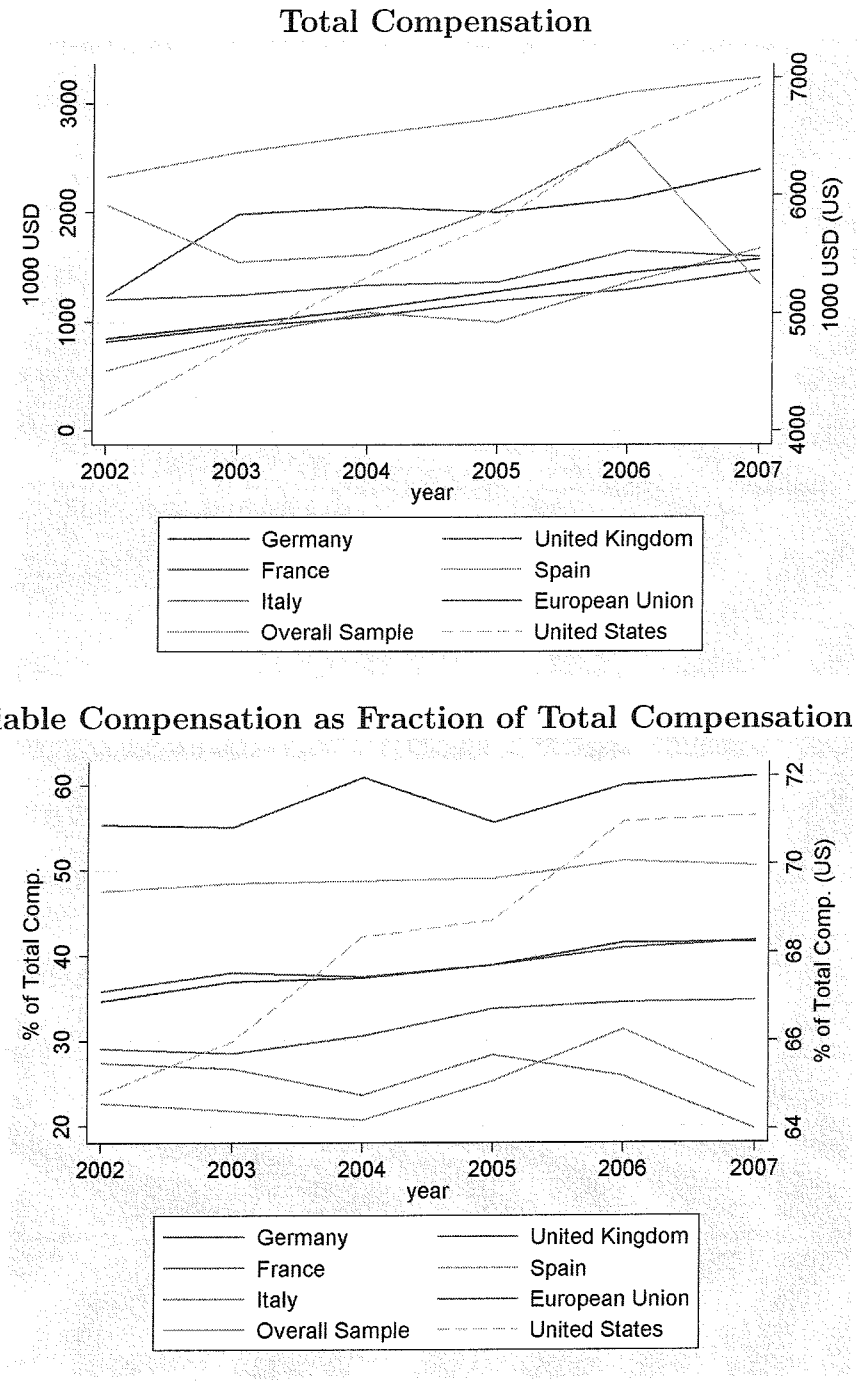
Figure 1 depicts the evolution of compensation over time. In the first panel we show how total compensation has evolved between 2002 and 2007 for Germany, France, Italy, Spain, the United Kingdom, the United States, for the European Union as a whole and for all countries in the sample. The scale on the right hand side refers to the United States as total compensation is much higher there than elsewhere. As we can see from the first panel, average total compensation has increased in almost all economies between 2002 and 2007. European Union countries started at levels of about 500,000 US$ (Spain) or slightly above 1mn US$ (Germany and France) and increased to in between 1,5mn US$ (France) and above 2mn US$ (Germany). For the overall European Union, average total compensation rose from slightly below

1mn US$ in 2002 to around 1.5mn US$ in 2007. The gap between the compensation level in the United States and European countries is tremendous. In the United States, average total compensation with 4mn US$ was almost four times as high as in the EU in 2002, and it increased to as much as 7mn US$ in 2007. While the levels of executive pay differ largely between the EU and the United States, they follow a similar trend. Average total compensation in the United States increased by 68 percent in the six years between 2002 and 2007, and it rose even by around 86 percent during the same time period in the European Union. Hence, the annual growth rate in total compensation reached almost 11 percent in the United States and 13 percent in the European Union.

The second panel of Figure 1 depicts the evolution of the fraction of variable pay in total compensation during the same time period. Once again we can observe a noticeable difference between European Union countries and the United States. Whereas in the latter, variable compensation accounts for more than two thirds of total compensation and increased from around 65 percent in 2002 to 71 percent in 2007, it just ranges between 35 and 42 percent of total remuneration in the European Union. The lowest values are recorded in countries such as Italy and Spain which seem to rely less on performance-sensitive pay and more on fixed, effort-independent remuneration. The highest values are found for Germany, where the share of variable pay accounts for up to 55-60 percent of total compensation.

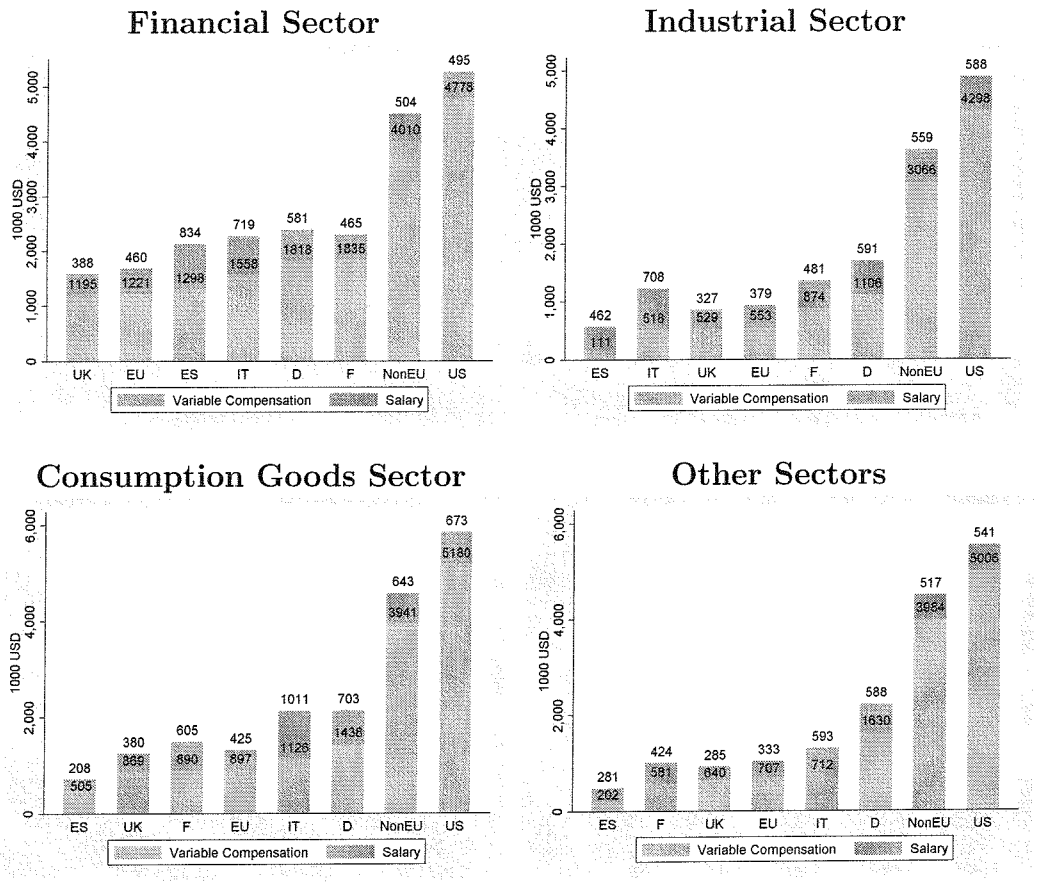
In the following, we scrutinize the relationship between salary (i.e., effort- independent compensation) and variable pay in different sectors of the economy for the countries mentioned above. As can be seen from Figure 2, the financial sector relies more heavily on variable compensation compared to the industrial, consumption goods sectors, or other sectors of the economy on average. Furthermore, the difference in the levels of variable pay between European Union countries and the United States appears to be lowest in this sector. Thus, the average amount of variable compensation in finance reaches 1,2mn US$ in the European Union and 4.8mn US$ in the United States. For the industrial sector, for instance, the discrepancy is larger since an executive receives on average 4.3mn US$ variable pay in the United States and only around 0.5mn US$ in the European Union.

Figure 1: Compensation Over Time in Different Countries



Notes: The graphs are based on data restricted to the time period 2002-2007. European Union includes Austria, Belgium, Cyprus, Czech Republic, Denmark, Germany, Finland, France, Greece, Hungary, Italy, Luxembourg, Netherlands, Norway, Poland, Portugal, Republic of Ireland, Spain, Sweden, United Kingdom. Variable compensation is defined as the sum of boni, the value of long-term incentive plans and the estimated value of options awarded. The sector classifications refer to the Global Industry Classification Standard (GICS) where finance refers to group 40, industry to group 20, consumer goods to groups 25 and 30 and others to the remainder

Figure 2: MEAN SALARY VS. MEAN VARIABLE COMPENSATION IN DIFFERENT SECTORS AND COUNTRIES



Notes: The graphs are based on data restricted to the time period 2002-2007. European Union includes Austria, Belgium, Cyprus, Czech Republic, Denmark, Germany, Finland, France, Greece, Hungary, Italy, Luxembourg, Netherlands, Norway, Poland, Portugal, Republic of Ireland, Spain, Sweden, United Kingdom. NonEU includes Argentina, Australia, Bermuda, Brazil, Canada, Cayman Islands, China, Croatia, Gabon, Gibraltar, Guernsey, Hong Kong, Iceland, India, Indonesia, Isle of Man, Israel, Japan, Jersey, Liechtenstein, Macau, Malaysia, Mexico, Morocco, Netherlands Antilles, New Zealand, Panama, Papua New Guinea, Puerto Rico, Russian Federation, South Africa, Switzerland, taiwan, Turkey, United States, United Arab Emirates and Virgin Islands, British. Variable compensation is defined as the sum of boni, the value of long-term incentive plans and the estimated value of options awarded. The sector classifications refer to the Global Industry Classification Standard (GICS) where finance refers to group 40, industry to group 20, consumer goods to groups 25 and 30 and others to the remainder

As depicted in Figure 2, the top overall compensation is recorded in the financial sector in the European Union and in the consumption goods sector in the United States. Furthermore, these bar graphs show that considerable differences exist in terms of variable compensation even between European countries, but to a lesser extent in terms of salary. Germany, France, and Italy offer the highest overall remuneration to their executives in the financial and industrial sectors. Whereas Germany, France, and the United Kingdom apparently rely more strongly on variable compensation, Italian companies award rather fixed salaries to their executives. The average salary exceeds the average variable compensation in the industrial sector and has almost the same level in the consumption goods sector in Italy. Moreover, as already shown in Figure 1, in the United States average variable compensation amounts to almost eight times fixed pay in the consumption goods sector and it is almost 10 times as high as fixed compensation in the financial sector.

4.2 REGRESSION RESULTS: TOTAL COMPENSATION

The compensation differences described above indicate that not only total compensation but also its composition varies across sectors (and countries). Yet, these differences could be driven by observable differences across managers and firms such as the education and the experience of the directors and/or the scale and profitability of the firms. Specifically, we aim at assessing whether these differences across sectors are statistically significant after controlling for observable characteristics of managers and firms. Even though we abstract from any causal interpretation here, such an analysis may help obtaining a more accurate estimate of the effective *wage premium* in the financial sector beyond descriptive statistics.

We aim at estimating the determinants of managerial pay by way of Mincer-type earnings equations that take into account firm-specific as well as director-specific characteristics. Following the seminal work of Mincer (1974), a large number of studies have analyzed the role of education and experience on earnings in different countries, sectors or time periods (for an overview see Psacharopoulo and Patrino (2002)). The typical Mincerian model specification specifies log-transformed earnings as a function of years of education and years of job-specific experience along with other covariates. Following Card and Krueger (1992) and Heckman, Layne-Farrar, and Todd (1996) who show that log earnings tend to be a nonlinear function of education, we include a quadratic education term in our specification of managerial pay:

$$ln(Y_i) = \alpha + \beta_1 Edu_i + \beta_2 Edu_i^2 + \beta_3 Exp_i + \beta_4 Exp_i^2 + \mathbf{X_i}\gamma + \delta Finance_i + \epsilon_i, \quad (1)$$

where Y_i denotes total annual compensation of director i, Edu_i the educational level, Exp_i the number of years director i has been employed in the specific role held, and

ϵ_i denotes an error term. The $1 \times K$ vector $\mathbf{X_i}$ refers to additional covariates we control for such as age, gender, the log of total number of employees of the firm, the firm's return on assets, the number of directors per employee and an indicator telling whether the director is the CEO of the company. Finally, we employ an indicator variable $Finance_i$ which is unity if a manager works in a firm in the financial sector. Ultimately, we aim at identifying the parameter δ which measures the semi-elasticity of compensation with respect to financial sector membership *conditional on other observable characteristics*. Accordingly, $\hat{\delta} \times 100$ is an estimate of the earnings premium of the financial sector compared to the sample average in percent. Since we pool our data over the period 2002-2007, we include year fixed effects in each specification. Moreover, we capture country specific compensation differences by country fixed effects. The fact that almost no directors switching from the financial sector to other industries or vice versa precludes us from estimating specifications with director fixed effects.

Table 3 illustrates the results for the earnings regressions using the total sample (column 1), the subset of EU countries (column 3), and the subset of Non-EU countries (column 5). Our estimate for the premium of the financial sector is about 40 percent for the total sample while it is about 60 percent and 20 percent in the EU and the Non-EU countries, respectively. These estimates are in line with Philippon and Reshef (2009) who identify a premium of 30 to 50 percent comparing the earnings of the financial sector in the USA to the rest of the private sector. However, Philippon and Reshef (2009) take into account all types of employees whereas our study exploits information on directors only. We expect that focusing on a more homogenous subgroup improves the comparability across sectors. The coefficient of the financial sector indicator is highly significant in each of these specifications. The controls we include feature the expected effects: age, education, and years in role exhibit a positive but diminishing effect on log earnings. A CEO receives about 60 percent higher total compensation than other directors, and females with similar characteristics are paid significantly less than males in similar positions and firms. Regarding the firm characteristics, we observe larger firms (measured in terms of their number of employees) paying significantly more. The same applies to more profitable firms in terms of their return on assets (ROA). Lastly, the number of directors per employee turns out to be significantly negatively correlated with the total compensation. This could be explained by a more or less fixed budget that is devoted to the board of a company with a given size. Overall, we find strong evidence for directors in the financial sector receiving more generous pay than their counterparts with similar characteristics in other sectors of the economy. This tendency seems to be more pronounced in Europe than in other parts of the world as the 90 percent confidence intervals of the δ coefficients in specifications (3) and (5) do not overlap.

Table 3: TOTAL COMPENSATION

	Total Sample		EU		Non-EU	
	Total	Finance	Total	Finance	Total	Finance
	(1)	(2)	(3)	(4)	(5)	(6)
Finance sector	.426 (.015)***		.597 (.018)***		.232 (.025)***	
Real Estate		.713 (.043)***		.462 (.059)***		.741 (.061)***
Other Finance		.630 (.039)***		.308 (.049)***		.993 (.077)***
Insurance		.362 (.038)***		.141 (.048)***		.490 (.058)***
Director Characteristics						
Age	.107 (.007)***	.129 (.017)***	.094 (.011)***	.034 (.027)	.121 (.011)***	.198 (.024)***
Age^2	-.001 (.00006)***	-.001 (.0002)***	-.001 (.0001)***	-.0004 (.0003)	-.001 (.00009)***	-.002 (.0002)***
Education	.222 (.012)***	.238 (.031)***	.163 (.015)***	.245 (.036)***	.295 (.021)***	.207 (.051)***
Education^2	-.033 (.003)***	-.047 (.008)***	-.021 (.004)***	-.045 (.009)***	-.048 (.005)***	-.043 (.012)***
Gender	-.132 (.031)***	-.103 (.063)*	-.149 (.038)***	-.195 (.085)**	-.124 (.049)**	.059 (.091)
CEO	.607 (.012)***	.598 (.030)***	.515 (.015)***	.507 (.037)***	.695 (.020)***	.675 (.046)***
Years in role	.018 (.003)***	.040 (.008)***	.044 (.004)***	.068 (.009)***	-.005 (.003)	.008 (.011)
Years in role^2	-.0007 (.0001)***	-.002 (.0004)***	-.001 (.0002)***	-.002 (.0005)***	-.0002 (.0001)	-.001 (.0005)**
Firm Characteristics						
Employees	.269 (.005)***	.253 (.014)***	.272 (.005)***	.201 (.017)***	.185 (.013)***	.257 (.026)***
Employees^2	.021 (.002)***	.022 (.004)***	.012 (.002)***	.012 (.005)***	.080 (.007)***	.082 (.012)***
Employees^3	-.001 (.0004)***	.004 (.001)***	-.0001 (.0005)	.007 (.001)***	-.010 (.001)***	-.012 (.002)***
ROA	.002 (.0003)***	.008 (.002)***	.001 (.0003)***	.006 (.002)***	.006 (.0008)***	.005 (.005)
Directors/Employees	-.004 (.001)***	-.006 (.002)**	-.002 (.001)*	-.002 (.003)	-.042 (.006)***	-.055 (.011)***
Const.	3.487 (.178)***	2.966 (.449)***	3.488 (.267)***	5.250 (.677)***	3.452 (.297)***	1.380 (.695)**
Country fixed effects	yes	yes	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes	yes	yes
N	35461	6776	19590	3785	15871	2991
R^2	.487	.466	.45	.492	.335	.385

Notes: ***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively. Robust standard errors are computed. We restrict our sample to executive directors and to the 2002-2007 period. Total compensation is defined as the sum of salary, boni, estimated values of options awarded and the value of long-term incentive plans. Total compensation as well as employees are measured in logarithmic terms. The first two columns refer to the total sample, the third and fourth focus on observations within the EU while columns five and six focus on non-EU observations. For each of these three subsamples we identify the overall effect of the financial sector as well as variations within the financial sector which is referred to in the second column of each subsample.

The financial sector consists of a rather heterogenous set of companies and the stylized facts suggest that the compensation levels differ sharply between more conservative commercial banks and riskier investment companies. The data-set at hand enables us to further differentiate between these distinctive types of businesses within the financial sector. In particular, we can assign companies to the following subsectors: commercial banks (GICS group 4010), insurance companies (GICS group 4030), real estate which primary covers real estate investment trusts (GICS group 4040), and other finance which covers for instance investment banks and asset management companies (GICS group 4020). Specifications (2), (4), and (6) in Table 3 focus on the subset of companies which are part of the financial sector. In these specifications we substitute the financial sector indicator by indicators for the respective subsectors real estate, insurances, and other finance. Hence, the commercial banking sector acts as the reference group. Again, the firm-specific and director-specific covariates exhibit the expected correlations and most of them are significant at conventional levels of confidence. In the overall sample (column 2) individuals in the real estate sector, the insurance sector, and the set of other financial businesses earn significantly higher compensation than the commercial banking sector. The same holds true for the subsample of EU and Non-EU countries. The magnitude of the compensation differences within the financial sector is remarkable. Within the EU, real estate investment firms feature the highest compensation while firms belonging to the other finance sector exhibit the highest earnings in Non-EU countries. This indicates that the premium of the overall financial sector is driven to a large extent by more specialized units as for example the investment banks, asset management firms or real estate investment trusts.

In each of the total compensation regressions, the CEOs received a significant premium as compared to other directors which can be explained by their specific position within the firm. Focusing on the compensation of chief executive officers may reduce unobservable differences in the job demands of the analyzed units across sectors. It seems plausible that job characteristics companies' leaders are facing are more similar across sectors than the ones of other members of the board. Therefore, we run the above specifications for the subset of CEOs separately in Table 4. Again, the financial sector features a highly significant premium in all specifications. Yet, the magnitude of the effect diminishes slightly. As for the sum of directors, we observe significant compensation disparities for CEOs in different subsectors of the financial sector which is illustrated in columns (2),(4), and (6) of Table 4. The lowest CEO compensation within the financial sector applies to commercial banks.

Table 4: Total Compensation (CEO/Chairman of the Board)

	Total Sample		EU		Non-EU	
	Total	Finance	Total	Finance	Total	Finance
	(1)	(2)	(3)	(4)	(5)	(6)
Finance sector	.329 (.023)***		.574 (.034)***		.200 (.030)***	
Real Estate		.659 (.064)***		.522 (.113)***		.562 (.078)***
Other Finance		.708 (.059)***		.395 (.098)***		.816 (.089)***
Insurance		.429 (.059)***		.193 (.088)**		.449 (.075)***
Director Characteristics						
Age	.084 (.010)***	.066 (.023)***	.058 (.016)***	-.039 (.043)	.098 (.013)***	.108 (.028)***
Age^2	-.0009 (.00009)***	-.0008 (.0002)***	-.0007 (.0001)***	.00009 (.0004)	-.001 (.0001)***	-.001 (.0002)***
Education	.258 (.020)***	.292 (.045)***	.203 (.027)***	.378 (.064)***	.312 (.026)***	.201 (.063)***
Education^2	-.038 (.005)***	-.061 (.010)***	-.025 (.007)***	-.067 (.014)***	-.053 (.006)***	-.045 (.014)***
Gender	-.018 (.057)	.107 (.115)	.056 (.103)	-.046 (.155)	-.082 (.068)	.132 (.158)
Years in role	.012 (.003)***	.037 (.011)***	.037 (.006)***	.060 (.016)***	.001 (.004)	.026 (.014)*
Years in role^2	-.0005 (.0001)***	-.002 (.0005)***	-.001 (.0002)***	-.002 (.0007)***	-.0003 (.0001)**	-.002 (.0006)**
Firm Characteristics						
Employees	.274 (.008)***	.262 (.022)***	.285 (.010)***	.213 (.032)***	.196 (.016)***	.235 (.033)***
Employees^2	.025 (.003)***	.027 (.006)***	.010 (.004)***	.008 (.007)	.077 (.008)***	.089 (.015)***
Employees^3	-.002 (.0007)***	.001 (.002)	-.0002 (.0008)	.006 (.002)***	-.009 (.001)***	-.011 (.003)***
ROA	.002 (.0006)***	.009 (.003)***	.001 (.0004)***	.005 (.003)*	.005 (.0009)***	.011 (.005)**
Directors/Employees	-.006 (.002)***	-.010 (.004)***	-.002 (.002)	-.004 (.004)	-.040 (.008)***	-.056 (.013)***
Const.	4.890 (.263)***	5.429 (.644)***	4.976 (.404)***	8.001 (1.142)***	4.820 (.352)***	4.572 (.810)***
Country fixed effects	yes	yes	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes	yes	yes
N	17,089	2,891	6,198	1,014	10,891	1,877
R^2	.436	.449	.441	.543	.294	.359

Notes: ***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively. Robust standard errors are computed.We restrict our sample to executive directors and to the 2002-2007 period. Total compensation is defined as the sum of salary, boni, estimated values of options awarded and the value of long-term incentive plans. Total compensation as well as employees are measured in logarithmic terms. The first two columns refer to the total sample, the third and fourth focus on observations within the EU while columns five and six focus on non-EU observations. For each of these three subsamples we identify the overall effect of the financial sector as well as variations within the financial sector which is referred to in the second column of each subsample.

4.3 REGRESSION RESULTS: VARIABLE COMPENSATION

Regarding the composition of compensation, Table 1 indicates that the financial sector receives a greater fraction of variable compensation compared to other sectors. To determine whether this difference is driven by observable firm or director characteristics we estimate the effect of the financial sector on variable compensation employing the same control variables as in equation 1 but substituting the dependent variable by variable compensation as a fraction of total compensation. Table 5 and 6 provide the results for the total sample and the subsample of CEOs, respectively. The fraction of variable compensation in the financial sector exceeds variable compensation in other sectors of the economy by about 7.7 percentage points. For the subset of EU countries the difference is even 11.5 percentage points while it amounts to 2.5 percentage points in Non-EU countries.

When focusing on CEOs (see Table 6) the results remain almost the same. The financial sector places significantly more emphasis on incentive compatible compensation than the other sectors considered. Comparing the subsectors of the finance industry, commercial banking follows a rather conservative compensation strategy whereas the real estate sector as well as the other finance sector allocate a significantly higher fraction of total remuneration to bonuses, options, and long term incentive plans (LTIPs). With respect to insurance companies, we observe a discrepancy between EU countries and Non-EU countries. In the former the compensation structure is not significantly different from the one applied by commercial banks while in the latter they put significantly more emphasis on variable compensation than commercial banking does.

Since the fraction of variable compensation is by definition limited to an interval between zero and unity, a standard linear model as utilized above may not be appropriate. Therefore, as a robustness check we estimate the sectoral differences in compensation structure by using a nonlinear fractional response model which ensures that the model prediction lies in the support region between zero and unity. Regarding functional form of the model we follow Papke and Wooldridge (1996) and Wooldridge (2002) to employ a fractional logit model. The corresponding results are summarized in Table 7. The correlations remain qualitatively unaffected in comparison to the linear models. Of course, the coefficients in Table 7 to the corresponding ones in Table 5, which may be interpreted as marginal effects. The reason is that the fractional logit model is nonlinear and marginal effects vary across observations. However, since the predictions of the linear models in Table 5 do generally not fall outside of the support region on the unit interval, the marginal effects in Tables 5 and 7 are quite similar on average.

Table 5: VARIABLE COMPENSATION

	Total Sample		EU		Non-EU	
	Total	Finance	Total	Finance	Total	Finance
	(1)	(2)	(3)	(4)	(5)	(6)
Finance sector	.077 (.004)***		.115 (.005)***		.025 (.005)***	
Real Estate		.131 (.011)***		.120 (.016)***		.129 (.015)***
Other Finance		.098 (.009)***		.083 (.013)***		.121 (.016)***
Insurance		.042 (.009)***		.0001 (.013)		.083 (.011)***
Director Characteristics						
Age	.021 (.002)***	.021 (.004)***	.020 (.002)***	.007 (.006)	.024 (.002)***	.036 (.005)***
Age^2	-.0002 (.00002)***	-.0002 (.00003)***	-.0002 (.00002)***	-.0001 (.00005)**	-.0003 (.00002)***	-.0004 (.00005)***
Education	.049 (.003)***	.054 (.007)***	.043 (.004)***	.063 (.009)***	.053 (.005)***	.036 (.012)***
Education^2	-.007 (.0007)***	-.011 (.002)***	-.006 (.0009)***	-.013 (.002)***	-.008 (.001)***	-.007 (.003)***
Gender	-.028 (.008)***	-.009 (.016)	-.010 (.010)	-.014 (.021)	-.052 (.012)***	-.002 (.024)
CEO	.043 (.003)***	.044 (.007)***	.022 (.004)***	.029 (.010)***	.064 (.005)***	.062 (.010)***
Years in role	-.002 (.0006)***	.003 (.002)**	.0008 (.0009)	.003 (.002)	-.004 (.0008)***	.001 (.002)
Years in role^2	-.00006 (.00002)**	-.0003 (.00008)***	-.0001 (.00004)***	-.0001 (.0001)	-1.00e-05 (.00003)	-.0003 (.00009)***
Firm Characteristics						
Employees	.045 (.001)***	.046 (.003)***	.052 (.001)***	.047 (.004)***	.018 (.003)***	.032 (.005)***
Employees^2	.002 (.0004)***	.001 (.0008)*	.002 (.0005)***	.0009 (.0009)	.010 (.001)***	.012 (.002)***
Employees^3	-.0004 (.00009)***	.0006 (.0002)***	-.0005 (.0001)***	.001 (.0002)***	-.002 (.0002)***	-.002 (.0004)***
ROA	.0007 (.0001)***	.002 (.0004)***	.0006 (.0001)***	.001 (.0004)***	.001 (.0002)***	.003 (.001)***
Directors/Employees	-.0003 (.0002)*	-.0006 (.0003)*	-.0002 (.0002)	-.0002 (.0004)	-.007 (.001)***	-.011 (.002)***
Const.	-.026 (.043)	-.023 (.100)	-.098 (.061)	.267 (.144)*	-.008 (.068)	-.367 (.149)**
Country fixed effects	yes	yes	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes	yes	yes
N	35,452	6,771	19,581	3,780	15,871	2,991
R^2	.347	.388	.269	.4	.184	.262

Notes: ***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively. Robust standard errors are computed. We restrict our sample to executive directors and to the 2002-2007 period. Variable compensation is defined as one minus total compensation where total compensation is the sum of salary, boni, estimated values of options awarded and the value of long-term incentive plans. Employees is measured in logarithmic terms. The first two columns refer to the total sample, the third and fourth focus on observations within the EU while columns five and six focus on non-EU observations. For each of these three subsamples we identify the overall effect of the financial sector as well as variations within the financial sector which is referred to in the second column of each subsample.

Table 6: Variable Compensation (CEO/Chairman of the Board)

	Total Sample		EU		Non-EU	
	Total	Finance	Total	Finance	Total	Finance
	(1)	(2)	(3)	(4)	(5)	(6)
Finance sector	.051 (.006)***		.111 (.010)***		.017 (.007)**	
Real Estate		.106 (.016)***		.094 (.033)***		.093 (.020)***
Other Finance		.108 (.014)***		.095 (.027)***		.107 (.020)***
Insurance		.063 (.013)***		-.002 (.027)		.085 (.015)***
Director Characteristics						
Age	.015 (.002)***	.003 (.006)	.016 (.005)***	-.008 (.012)	.017 (.003)***	.015 (.007)**
Age^2	-.0002 (.00002)***	-.00009 (.00005)*	-.0002 (.00004)***	-.00003 (.0001)	-.0002 (.00003)***	-.0002 (.00006)***
Education	.051 (.005)***	.055 (.011)***	.046 (.007)***	.059 (.017)***	.055 (.006)***	.037 (.016)**
Education^2	-.007 (.001)***	-.011 (.002)***	-.006 (.002)***	-.011 (.003)***	-.009 (.001)***	-.008 (.003)**
Gender	-.030 (.014)**	.011 (.030)	-.021 (.027)	-.063 (.053)	-.042 (.016)***	.036 (.030)
Years in role	-.0007 (.0008)	.008 (.003)***	.003 (.002)*	.008 (.004)**	-.003 (.0009)***	.007 (.003)***
Years in role^2	-.00008 (.00003)***	-.0004 (.0001)***	-.0001 (.00006)**	-.0001 (.0001)	-.00005 (.00003)	-.0005 (.0001)***
Firm Characteristics						
Employees	.036 (.002)***	.035 (.005)***	.045 (.003)***	.036 (.008)***	.015 (.003)***	.022 (.007)***
Employees^2	.002 (.0007)***	.002 (.001)	.002 (.0008)**	.0002 (.002)	.011 (.002)***	.013 (.002)***
Employees^3	-.0003 (.0001)**	.0007 (.0003)**	-.0003 (.0002)	.002 (.0004)***	-.001 (.0003)***	-.001 (.0005)***
ROA	.0008 (.0002)***	.002 (.0007)**	.0006 (.0002)***	.001 (.0007)	.001 (.0002)***	.004 (.001)***
Directors/Employees	-.0005 (.0003)*	-.0008 (.0006)	-.00007 (.0003)	.0002 (.0006)	-.008 (.001)***	-.010 (.002)***
Const.	.211 (.066)***	.549 (.167)***	.023 (.119)	.831 (.316)***	.255 (.081)***	.292 (.196)
Country fixed effects	yes	yes	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes	yes	yes
N	17088	2891	6197	1014	10891	1877
R^2	.356	.382	.257	.436	.179	.251

Notes: ***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively. Robust standard errors are computed. We restrict our sample to executive directors and to the 2002-2007 period. Variable compensation is defined as one minus total compensation where total compensation is the sum of salary, boni, estimated values of options awarded and the value of long-term incentive plans. Employees is measured in logarithmic terms. The first two columns refer to the total sample, the third and fourth focus on observations within the EU while columns five and six focus on non-EU observations. For each of these three subsamples we identify the overall effect of the financial sector as well as variations within the financial sector which is referred to in the second column of each subsample.

Table 7: VARIABLE COMPENSATION - NONLINEAR MODEL

	Total Sample		EU		Non-EU	
	Total	Finance	Total	Finance	Total	Finance
	(1)	(2)	(3)	(4)	(5)	(6)
Finance sector	.349 (.030)***		.508 (.040)***		.120 (.047)***	
Real Estate		.620 (.091)***		.538 (.145)***		.594 (.125)***
Other Finance		.469 (.081)***		.349 (.118)***		.583 (.143)***
Insurance		.200 (.080)**		-.0003 (.122)		.380 (.114)***
Director Characteristics						
Age	.095 (.012)***	.108 (.027)***	.105 (.020)***	.076 (.047)	.107 (.018)***	.164 (.040)***
Age^2	-.001 (.0001)***	-.001 (.0002)***	-.001 (.0002)***	-.001 (.0005)**	-.001 (.0002)***	-.002 (.0003)***
Education	.227 (.025)***	.240 (.060)***	.195 (.032)***	.288 (.077)***	.247 (.040)***	.158 (.101)
Education^2	-.033 (.006)***	-.049 (.015)***	-.027 (.008)***	-.059 (.019)***	-.039 (.011)***	-.030 (.027)
Gender	-.130 (.064)**	-.049 (.147)	-.050 (.086)	-.049 (.190)	-.234 (.094)**	-.009 (.234)
CEO	.199 (.026)***	.212 (.060)***	.108 (.034)***	.154 (.086)*	.302 (.038)***	.298 (.087)***
Years in role	-.008 (.005)	.021 (.013)	.005 (.008)	.016 (.018)	-.019 (.007)***	.012 (.019)
Years in role^2	-.0003 (.0002)	-.002 (.0005)***	-.0006 (.0004)*	-.0006 (.0008)	-.00003 (.0002)	-.002 (.0007)***
Firm Characteristics						
Employees	.189 (.010)***	.196 (.028)***	.224 (.013)***	.194 (.037)***	.084 (.024)***	.143 (.053)***
Employees^2	.011 (.004)***	.015 (.008)*	.011 (.004)**	.007 (.009)	.049 (.013)***	.067 (.025)***
Employees^3	-.002 (.0008)**	.003 (.002)	-.002 (.001)**	.005 (.003)**	-.007 (.002)***	-.007 (.005)
ROA	.006 (.0007)***	.013 (.004)***	.007 (.001)***	.010 (.005)**	.005 (.001)***	.017 (.009)*
Directors/Employees	-.004 (.002)*	-.007 (.005)	-.003 (.002)	-.003 (.005)	-.033 (.011)***	-.053 (.022)**
Const.	-.628 (1.280)	-2.192 (.747)***	-2.959 (.557)***	-3.428 (1.386)**	-1.538 (1.366)	-3.909 (1.164)***
Country fixed effects	yes	yes	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes	yes	yes
R^2	35,452	6,771	19,581	3,780	15,871	2,991
R^2						

Notes: ***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively. We restrict our sample to executive directors and to the 2002-2007 period. Variable compensation is defined as one minus total compensation where total compensation is the sum of salary, boni, estimated values of options awarded and the value of long-term incentive plans. Employees is measured in logarithmic terms. The first two columns refer to the total sample, the third and fourth focus on observations within the EU while columns five and six focus on non-EU observations. For each of these three subsamples we identify the overall effect of the financial sector as well as variations within the financial sector which is referred to in the second column of each subsample.

5. CONCLUSIONS

In the aftermath of the financial crisis at the end of the first decade of the century, both policymakers and academics have raised concerns that certain characteristics of the financial sector such as its size and concentration, the large risks involved in certain financial transactions, or the value-added tax exemption of many financial services may lead to economic rents which should be redistributed. One concern raised was and still is that a significant share of those rents is reaped in the form of higher remuneration of executives employed in the financial sector compared to their counterparts in other sectors. In the light of these debates, our paper scrutinizes both the level and composition of the compensation of directors employed in the financial sector and in some of its subsectors compared to other executives with similar characteristics working in other branches of the economy. In particular, using a large set of data on directors' compensation in several sectors and countries, our findings indicate that there is a significant earnings premium in the financial sector which amounts for the overall sample to about 40 percent after conditioning out observable director-specific and firm-specific characteristics. Yet, there is considerable heterogeneity of earnings across different types of businesses within the financial sector.

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ANNEX 5

IS THE FINANCIAL SECTOR UNDER-TAXED? EMPIRICAL PART

Since the adoption of the Sixth VAT Directive in 1977, the EU's common value added tax system has generally exempted mainstream financial services including insurances and investment funds. Article 135(1) of the VAT Directive provides an exemption from VAT for most financial and insurance services[1].

To some extent the Directive reflects an uncertain approach in that it also allows EU Member States to grant taxable persons the option of taxing financial services – to the extent that this is technically possible. The difficulty is, however, to technically define the price for specific financial operations. Around 2/3 of all financial services are margin based which makes the implementation of the invoice-credit VAT system very difficult in this respect.[2] In practice however this difficulty seems to be surmountable – for instance in Germany when the granting of loans is subject to VAT under the option to tax, an acceptable methodology seems to have been found to tax these margin-based operations.

The extent to which applying VAT to the financial sector would raise additional tax revenues and – consequently – the extent to which the exemption constitutes a tax advantage for the financial sector is an unsettled empirical question. Whereas the exemption means that the financial sector does not charge VAT on most of its output, it cannot deduct the VAT charged on its inputs. This is known as the 'irrecoverable VAT problem'. While estimates by Genser and Winker (1997) for Germany (DM 7 billion for 1994) and Huizinga (2002) for the EU-15 (EUR 12 billion for 1998) suggest that there might be a sizeable tax advantage, arguments are also put forward that claim that irrecoverable VAT is the largest tax burden for the sector.

This Annex presents a new estimate of the magnitude of the problem. The calculations are based on European Sector Accounts (ESA) data on the consumption of financial services by sectors. The data are provided by Eurostat for the period from 2000 to 2009. However, this data (Financial intermediation services indirectly measured, FISIM) is restricted to financial intermediation. Other tax exempt financial services are not covered in these figures. The share of FISIM in the total gross value added of the financial sector (S12) was around 35% in the EU-27 in 2009. The estimations below are based on methodologies applied by Huizinga (2002) and De la Feria and Lockwood (2010).

For the calculations ESA variables and sectors listed in table (1) have been used. In addition to this the variable 'intermediate consumption' from national Input-Output (IO) tables as provided by Eurostat was used in addition to variable P2. The reason is that the

[1] Commission proposals for a Directive COM(2007)747 and a Regulation COM(2007)746 as regards the VAT treatment of insurance and financial services aim at modernising and simplifying the current complex VAT rules for financial and insurance services and securing a level playing field in the pan-EU market for these services as far as VAT is concerned.

[2] The problem of VAT on financial services is described in more detail in Kerrigan (2008) as well as in Mirrlees et al. (2010), chapter 8.

IO-tables offer more detailed data for this variable. While in ESA the financial sector (S12) is the aggregate of financial intermediation, insurance and auxiliary financial services, the IO tables have separate values for the three segments which allows a better estimation basis of the share of irrecoverable VAT.

In order to calculate the irrecoverable VAT two other sources have been consulted. Firstly, the VAT revenue ration (VRR) from the Consumption Tax Trends published by the OECD (2011). This figure was used in order to take into account that not all value-added is usually taxed. The VRR measures the difference between the VAT revenue actually collected and what would theoretically be raised if VAT was applied at the standard rate to the entire potential tax base in a "pure" VAT regime and all revenue was collected. Here the strong assumption is taken that the national values currently observed in Member States would also hold for the financial sector. In cases where this data is missing, the country or EU averages have been used to impute missing values. Secondly, there are unfortunately no national estimates on the share of irrecoverable VAT and for this reason the average non-recovery rate of 0.79 from PricewaterhouseCoopers (2006) has been used best available proxy. This approach is similar to the one taken by De la Feria and Lockwood (2010) in Appendix A of their study. The only difference is that they used OECD IO tables instead of Eurostat's tables.

Table (1). List of variable

ESA code	Label of Variable	Source
S1	Total Economy	ESA, Eurostat
S2	Rest of the World	ESA, Eurostat
S11	Non-financial corporations	ESA, Eurostat
S12	Financial corporations	ESA, Eurostat
S13	General government	ESA, Eurostat
S14_S15	Households; non profit-institutions serving households	ESA, Eurostat
B1GM	Gross domestic product at market prices	ESA, Eurostat
B1G	Gross Value added at basic prices	ESA, Eurostat
P2	Intermediate consumption	ESA and IO tables, Eurostat
P51	Gross fixed capital formation	ESA, Eurostat
D41	Interest	ESA, Eurostat
D41G	Total interest before FISIM allocat	ESA, Eurostat
VRR	VAT revenue ratio	OECD (2011)

In order to calculate the consumption of financial intermediation for the different sector the following calculation has been applied. For sectors consuming FISIM (S11, S13, S14_S15) the FISIM consumed is sum of the differences in their interest streams:

$$FISIM = (D41_paid - D41G_paid) + (D41G_received - D41_received)$$

Since non-financial corporations are VAT exempt only the consumption of household and government has been considered in the calculation of the hypothetical VAT tax base.

Note that in fact these sectors consume the larger share of financial services. In 2009 the share of these sectors in total FISIM consumption was around 55%.

Three estimation approaches have been chosen. The difference between them is the data basis for the calculation of the irrecoverable VAT which in case of a VAT application would be fully deductible. In estimation 1 the basis for the calculation is the data on "Intermediate consumption" by the sector "Financial intermediation, except insurance and pension funding" from the "Use" tables of national Input-Output data as provided by Eurostat.

In estimation 2 "Intermediate Consumption" is taken directly from the European Sector Accounts (variable P2). In contrast to the Input-Output tables, the data in the sector accounts are however wider defined. They cover the whole financial sector (variable S12) with financial intermediation as one subgroup together with insurance and auxiliary financial services. In order to account for the fact that the FISIM data only covers the value-added from financial intermediation but not the other two subsectors, the values have been corrected. The assumption used for this correction is that the share of irrecoverable VAT for financial intermediation is equal to the share of FISIM in the Gross Value Added of the financial sector in total. The third estimation approach is wider and adds to the deductible "Intermediate Consumption" also "Gross Fixed Capital Formation" (variable P51) as VAT deductible.

Table (2). VAT exemption of the financial sector: Potential tax advantage

	Estimation 1		Estimation 2		Estimation 3	
Year	b. EUR	% of GDP	b. EUR	% of GDP	b. EUR	% of GDP
2000	13.7	0.15	16.3	0.18	14.2	0.15
2001	14.1	0.15	16.9	0.18	14.9	0.16
2002	15.2	0.15	19.0	0.19	17.2	0.17
2003	17.2	0.17	20.5	0.20	19.1	0.19
2004	18.3	0.17	21.7	0.20	20.1	0.19
2005	17.6	0.16	21.5	0.19	20.0	0.18
2006	14.4	0.12	21.9	0.19	20.2	0.17
2007	13.7	0.11	23.0	0.19	21.5	0.17
2008	14.1	0.11	22.6	0.18	21.0	0.17
2009*	18.1	0.15	19.2	0.16	17.8	0.15

*Note that no data is available for the UK for 2009 in estimations 2 and 3 which explains the decline in 2009. Source: Own calculations based on Eurostat and OECD data.

The results for the three estimates are shown in table (2). The most reliable data is the one from estimation 1 where the intermediate consumption of the financial intermediation can be directly measured using the Input-Output tables. The data suggest that the VAT exemption leads to an advantage in the range of 0.11% and 0.17% of GDP. This is in line with the results of Huizinga (2002) who estimates for the EU-15 with data from 1998 a value of around 0.15% of GDP. It should be noted that all these estimates are very rough approximations and should be interpreted with caution given the strong assumptions made when calculating the irrecoverable VAT. However, they indicate that the argument that the VAT exemption of financial services might be an advantage for the financial sector has some merits. The results do not change strongly when other estimates for the irrecoverable VAT are used.

Note that the estimates do not take into account the behavioural response due to price changes when applying VAT. The inclusion of the financial sector in the VAT would indeed lead to price changes, but such changes should be seen as the correction of an existing distortion rather than as a new distortion. The reason is that next to the question of whether VAT on financial services would raise revenues, there is an economic distortion arising from the current VAT exemption. While services provided to households are too cheap, services to businesses are more expensive. This leads to a misallocation of the consumption of financial services.

In summary, the VAT exemption for a large share of financial services is an important issue. It results in the problem that there might be a preferential treatment of the financial sector compared with other sectors of the economy as well as in a distortion of prices.

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ANNEX 6

PROFITABILITY IN THE FINANCIAL SECTOR.

6.1. Profitability in the financial and non-financial sectors.

This annex uses information contained in the Orbis database on financial accounts of companies to investigate the profitability profile of the financial sector. The financial sector is defined as companies with a primary nace 4 digit code comprised between 6400 and 6699. The non-financial sector is composed of the other companies.

Profitability is defined as the return on shareholders' funds (RoE) and the return on assets (RoA). For each measure of the profit, 5 indicators are provided: the mean, the median, the standard deviation, the skweness and the kurtosis.

The standard deviation provides an indication of how values are concentrated around the mean. A high standard deviation corresponds to a large dispersion.

Next, the skewness is defined as $\frac{\frac{1}{n}\sum_{i=1}^{n}\left(x_i-\bar{x}\right)^3}{\left(\frac{1}{n}\sum_{i=1}^{n}\left(x_i-\bar{x}\right)^2\right)^{3/2}}$**, or the ratio of the third moment to the standard deviation exponent 3/2. The Skewness of a distribution indicates its asymmetry. If negative, it is defined as left-skewed. It indicates that the tail on the left-hand size is longer than on the right-hand side. That is most of the observations are concentrated on the right and that the mean is driven down by a small number of small observations. Alternatively, when it is positive (or right-skewed), most observations are concentrated on the left with few extreme observations on the right.**

Finally, the kurtosis is defined as $\frac{\frac{1}{n}\sum_{i=1}^{n}\left(x_i-\bar{x}\right)^4}{\left(\frac{1}{n}\sum_{i=1}^{n}\left(x_i-\bar{x}\right)^2\right)^{2}}-3$**. The kurtosis is an indication of how many extreme observations are contained in the sample. A higher kurtosis indicates a higher presence of extreme observations (i.e. observations that diverge from the mean).**

The results of the analysis for country-year pairs are presented in table (1). First, qualitatively, the choice of indicator between RoE and RoA does not change the relative performance of the financial and non-financial sector, that is if one indicator is higher in a sector compared to the other sector, then the same is true for the other indicator in almost all cases.

When considering RoE, the financial sector is more profitable than the non-financial sector in 47 of the 135 cases (i.e. 5 years times 27 Member States). The number is 45 cases when RoA is considered. The financial sector was more profitable than the non-financial sector in

10 Member States in 2005, in 9 in 2006, in 6 in 2007, in 8 in 2008 and in 14 in 2009. In particular, the sector was consistently more profitable in Greece, Spain, Hungary, Malta, Portugal, Romania, and the United Kingdom.

The results shall however be taken with extreme caution for several reasons. First, the sample is not necessarily representative because this annex uses all available information. For example, Belgium seems to be more complete than, say, Germany in terms of coverage of the total population of companies. Second, the number of observations varies across years. This means that we do not have a balanced panel. Third, the number of observations is small for several countries. This means that the presence of outliers will bear proportionally more on averages.

Table (1): Mean and Median Profitability per country and year.

MS	Year	Financial Sector							Non-Financial Sector						
			RoE			RoA				RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd	Number	Mean	Median	Sd	Mean	Median	Sd
AT	2005	211	10.8	8.9	10.7	1.3	0.6	3.3	86	18.7	12.9	24.1	7.9	4.5	9.9
AT	2006	224	9.3	7.7	10.0	1.0	0.6	2.3	370	21.8	14.8	26.1	7.0	4.2	9.7
AT	2007	225	9.8	7.3	10.0	1.2	0.6	2.9	398	20.6	17.4	28.4	7.5	5.1	13.0
AT	2008	230	3.7	3.3	13.3	0.6	0.2	2.7	616	20.4	14.4	26.5	7.6	4.8	10.1
AT	2009	234	4.8	4.1	12.2	0.8	0.2	4.1	1,090	17.8	13.1	24.6	6.6	4.2	9.9
AT	Aver.	225	7.7	6.2	11.3	1.0	0.4	3.1	512	19.9	14.5	26.0	7.3	4.6	10.6
BE	2005	3,012	13.1	5.7	24.4	5.8	2.0	12.1	169,247	16.6	11.4	26.3	7.0	4.0	12.3
BE	2006	3,547	13.2	5.5	24.4	6.1	2.2	12.4	202,684	16.8	11.5	26.1	7.2	4.1	12.4
BE	2007	3,718	13.9	6.2	24.7	6.5	2.6	12.7	218,085	17.4	12.0	26.5	7.5	4.4	12.7
BE	2008	3,923	12.0	4.7	25.0	5.4	2.0	12.5	233,817	16.1	10.6	27.0	7.1	3.9	13.1
BE	2009	4,154	11.9	4.8	24.9	5.7	2.1	13.1	253,916	15.1	9.5	27.1	6.6	3.5	13.2
BE	Aver.	3,671	12.8	5.4	24.7	5.9	2.2	12.6	215,550	16.4	11.0	26.6	7.1	4.0	12.8
BG	2005	105	25.7	20.3	25.7	8.2	3.8	14.3	7,083	31.7	27.4	29.2	10.7	6.0	13.2
BG	2006	148	24.8	19.9	27.2	9.3	3.8	14.7	12,152	33.3	28.8	29.1	11.6	6.7	15.9
BG	2007	226	25.5	19.4	28.0	10.4	5.1	16.7	17,837	36.5	33.2	29.8	14.4	8.9	16.4
BG	2008	238	21.9	15.6	30.5	8.0	3.8	16.3	21,756	31.3	27.7	28.0	13.5	8.2	16.5
BG	2009	280	14.9	8.8	25.9	6.8	2.6	14.3	25,780	18.1	13.2	25.6	8.4	4.4	14.7
BG	Aver.	199	22.6	16.8	27.5	8.5	3.8	15.3	16,922	30.2	26.1	28.4	11.7	6.8	15.4
CY	2005	4	17.4	14.7	20.8	0.4	0.5	0.6	5	14.3	18.3	7.3	4.9	4.5	2.6
CY	2006	5	21.9	17.9	9.8	0.7	0.7	0.3	6	22.9	23.8	14.8	5.1	5.4	5.1
CY	2007	6	20.0	23.3	8.4	1.3	1.4	0.6	10	27.0	21.8	21.4	6.3	4.8	6.5
CY	2008	7	2.4	12.8	22.6	-4.6	0.1	12.3	10	21.5	27.5	16.1	6.8	6.2	6.5
CY	2009	7	20.5	15.4	24.4	5.8	0.9	13.2	12	12.6	13.7	12.6	4.6	4.1	6.4
CY	Aver.	6	16.5	16.8	18.5	0.7	0.7	8.1	9	19.7	21.0	15.2	5.5	5.0	5.6
CZ	2005	144	18.4	14.4	26.5	6.3	2.5	14.2	22,543	18.6	11.4	27.0	8.2	4.3	13.9
CZ	2006	171	15.4	12.8	19.9	5.2	2.1	10.6	28,633	20.0	12.5	27.8	8.7	4.6	14.4

MS	Year	Financial Sector							Non-Financial Sector						
			RoE			RoA				RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd	Number	Mean	Median	Sd	Mean	Median	Sd
CZ	2007	192	16.2	11.3	23.3	5.7	2.3	10.7	34,236	20.7	13.5	28.1	9.3	5.0	14.8
CZ	2008	202	13.0	7.9	26.3	5.2	1.7	12.2	40,101	17.2	9.8	27.5	8.1	3.6	14.9
CZ	2009	224	16.2	9.8	27.1	6.6	2.9	13.9	46,662	13.3	5.5	27.4	5.7	1.9	14.1
CZ	Aver.	187	15.8	11.2	24.8	5.8	2.3	12.4	34,435	17.9	10.5	27.5	8.0	3.9	14.4
DE	2005	2,000	10.8	9.1	11.0	1.2	0.5	3.5	16,430	23.8	18.2	26.8	7.4	4.9	9.9
DE	2006	2,062	9.5	7.8	11.1	1.2	0.5	3.8	20,933	25.1	19.8	26.9	8.1	5.6	10.2
DE	2007	2,106	8.4	6.7	10.4	1.2	0.4	4.5	22,746	24.9	19.3	27.3	8.2	5.6	10.4
DE	2008	2,159	6.6	4.8	11.0	1.0	0.3	4.1	30,541	23.9	17.9	28.1	8.1	5.3	11.2
DE	2009	2,197	9.2	7.5	12.6	1.4	0.5	5.1	33,723	21.3	15.4	27.6	7.3	4.8	11.0
DE	Aver.	2,105	8.9	7.2	11.2	1.2	0.4	4.3	24,875	23.8	18.1	27.3	7.8	5.2	10.6
DK	2005	6,196	17.3	9.7	24.8	11.6	5.9	17.3	51,326	24.6	19.4	29.2	13.1	8.5	17.9
DK	2006	10,121	15.9	7.2	25.5	10.9	4.7	18.2	86,040	24.6	19.0	29.4	13.3	8.5	18.2
DK	2007	11,731	13.4	5.4	24.9	9.5	3.9	18.1	99,580	23.3	17.0	29.8	13.0	7.8	18.7
DK	2008	11,949	4.0	0.8	26.1	2.5	0.6	19.2	110,360	16.5	9.5	30.8	8.9	4.4	19.1
DK	2009	13,725	7.3	3.1	23.7	5.2	2.1	16.6	124,486	13.2	7.0	28.8	7.2	3.4	17.3
DK	Aver.	10,744	11.6	5.3	25.0	7.9	3.4	17.9	94,358	20.4	14.4	29.6	11.1	6.5	18.2
EE	2005	590	26.9	19.9	33.6	17.0	8.8	24.8	31,534	24.5	18.6	31.5	15.0	8.6	22.5
EE	2006	771	27.1	17.9	34.7	16.9	7.8	26.1	36,557	26.5	20.6	32.4	16.5	9.8	23.6
EE	2007	920	19.1	8.0	32.9	11.9	3.7	24.2	41,883	24.7	18.3	32.1	15.7	8.6	23.4
EE	2008	866	12.0	1.3	32.6	7.9	0.0	24.6	45,618	17.6	9.5	31.6	11.6	3.7	23.2
EE	2009	1,120	15.0	4.2	29.8	8.4	1.6	20.3	49,539	12.1	3.9	30.1	7.9	0.1	21.8
EE	Aver.	853	20.0	10.3	32.7	12.4	4.4	24.1	41,026	21.1	14.2	31.5	13.3	6.2	22.9
EL	2005	64	16.2	12.7	22.3	5.1	2.0	8.6	14,866	13.4	6.8	24.9	4.0	2.3	9.0
EL	2006	71	13.7	11.9	22.4	3.9	2.0	8.2	16,275	14.5	7.9	25.2	4.4	2.6	9.0
EL	2007	75	18.0	13.8	26.1	5.9	2.9	9.4	17,067	15.6	8.6	25.9	4.7	2.7	9.4
EL	2008	77	19.5	15.5	27.2	5.7	3.2	10.9	18,484	14.1	7.0	25.7	4.3	2.2	9.6
EL	2009	81	11.2	8.3	26.9	4.1	1.8	12.5	19,468	11.1	5.1	24.6	3.2	1.7	8.9
EL	Aver.	74	15.7	12.4	25.1	4.9	2.4	10.1	17,232	13.7	7.1	25.2	4.1	2.3	9.2
ES	2005	1,761	17.9	10.2	25.6	7.3	4.0	12.6	279,692	16.5	11.4	24.4	5.6	3.1	9.9
ES	2006	1,922	17.7	11.0	25.7	7.2	3.8	12.6	307,648	16.9	11.6	24.6	5.7	3.1	10.0
ES	2007	1,815	17.8	10.9	26.1	7.6	4.1	13.6	310,903	17.8	12.5	24.0	6.2	3.4	10.3
ES	2008	2,808	12.7	17.3	17.3	17.3	17.3	17.3	384,246	12.1	7.5	23.5	4.4	2.1	10.5
ES	2009	3,116	12.3	6.8	24.2	5.2	2.4	12.1	404,546	8.6	4.7	22.8	3.0	1.4	10.0
ES	Aver.	2,284	15.7	9.2	25.4	6.4	3.3	13.0	337,407	14.4	9.5	23.9	5.0	2.6	10.1
FI	2005	880	19.1	12.5	26.0	11.5	7.3	17.3	44,267	26.2	23.1	30.4	14.0	10.5	18.0
FI	2006	1,063	20.5	12.3	26.6	12.7	7.3	18.5	57,373	25.9	22.7	29.6	13.8	10.5	17.4
FI	2007	1,687	17.9	9.5	27.6	12.0	5.4	20.6	75,073	23.7	19.8	29.4	12.8	8.8	17.5
FI	2008	2,099	12.1	3.2	30.2	8.2	1.6	23.2	87,900	20.8	15.7	30.0	11.4	6.8	18.2

MS	Year	Financial Sector							Non-Financial Sector						
			RoE			RoA				RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd	Number	Mean	Median	Sd	Mean	Median	Sd
FI	2009	2,515	14.0	5.1	27.5	9.5	2.9	20.8	98,575	17.5	11.1	29.9	9.4	4.8	17.7
FI	Aver.	1,649	16.7	8.5	27.6	10.8	4.9	20.2	72,638	22.8	18.5	29.8	12.3	8.3	17.8
FR	2005	3,922	17.6	10.5	27.3	8.0	4.3	14.2	382,336	26.5	21.7	30.0	10.3	7.3	13.5
FR	2006	4,791	18.0	10.4	27.2	8.6	4.5	14.7	466,651	27.1	22.2	30.3	10.6	7.5	13.9
FR	2007	5,545	18.2	10.6	27.8	8.8	4.7	15.1	521,123	28.0	23.4	30.5	11.1	8.0	14.2
FR	2008	6,360	16.6	9.2	28.2	7.9	4.2	15.2	578,152	25.7	20.8	30.9	10.3	7.1	14.5
FR	2009	7,492	15.6	8.3	27.5	7.5	3.8	14.4	655,703	23.1	17.9	31.3	9.3	6.2	14.7
FR	Aver.	5,622	17.2	9.8	27.6	8.2	4.3	14.8	520,793	26.1	21.2	30.6	10.3	7.2	14.2
HU	2005	512	18.8	15.4	26.7	10.2	6.2	16.6	115,363	17.1	11.2	27.8	9.4	5.1	17.4
HU	2006	241	22.6	20.1	23.2	10.2	7.3	12.0	46,339	19.9	14.2	25.1	8.6	5.4	12.5
HU	2007	476	21.6	17.0	27.9	10.5	6.7	16.1	98,866	18.6	12.3	27.2	9.5	5.3	16.4
HU	2008	569	19.8	14.1	29.6	9.8	5.7	16.9	108,357	17.5	10.8	28.1	9.1	4.8	17.3
HU	2009	1,035	16.9	10.6	30.3	8.6	4.0	18.4	203,419	14.9	8.2	28.7	7.6	3.5	17.7
HU	Aver.	567	19.9	15.4	27.6	9.8	6.0	16.1	114,469	17.6	11.4	27.4	8.9	4.8	16.4
IE	2005	186	19.6	14.1	24.9	7.4	11.4	12.8	4,730	20.3	6.2	29.3	11.4	2.2	19.8
IE	2006	212	19.1	14.6	24.8	5.7	12.6	12.0	5,400	20.8	6.6	29.4	11.5	1.7	19.6
IE	2007	294	17.9	13.9	23.3	5.3	11.4	10.6	6,237	19.9	6.0	28.7	11.0	1.3	18.8
IE	2008	344	18.4	9.9	27.8	5.2	8.8	11.5	7,166	15.9	4.2	28.9	8.8	1.1	19.1
IE	2009	459	17.2	6.7	27.5	4.5	8.3	12.0	9,066	14.2	2.7	30.2	7.6	0.4	19.6
IE	Aver.	299	18.5	11.8	25.7	5.6	10.5	11.8	6,520	18.2	5.1	29.3	10.1	1.3	19.4
IT	2005	1,953	14.2	8.2	22.7	3.8	1.3	8.5	291,491	23.8	18.5	29.8	5.2	2.9	8.8
IT	2006	2,137	15.6	10.2	24.0	4.3	1.5	9.3	322,930	25.7	20.5	30.4	5.7	3.2	9.2
IT	2007	4,202	10.6	5.7	23.0	3.6	1.3	10.6	494,947	19.9	14.0	31.0	4.7	2.3	10.6
IT	2008	4,456	8.5	3.4	23.7	3.0	0.9	11.2	554,326	17.1	10.2	30.2	4.1	1.8	10.7
IT	2009	4,834	8.0	2.5	23.7	2.5	0.6	10.5	628,180	14.8	8.1	29.8	3.4	1.5	10.4
IT	Aver.	3,516	11.4	6.0	23.4	3.4	1.1	10.1	458,375	20.2	14.3	30.2	4.6	2.4	10.0
LT	2005	8	24.8	24.3	19.0	11.7	11.1	10.5	878	25.5	20.9	25.3	10.8	7.7	12.6
LT	2006	11	30.0	27.2	24.0	14.7	11.5	12.6	1,003	29.2	24.6	26.0	12.1	8.9	12.7
LT	2007	11	28.4	30.4	32.3	14.7	18.9	13.0	1,055	28.9	25.5	26.6	12.4	9.7	13.0
LT	2008	11	30.1	26.9	30.3	9.7	5.2	10.1	1,262	21.1	16.6	28.8	9.3	5.9	13.8
LT	2009	12	24.7	24.3	30.9	10.4	8.0	16.3	1,308	11.5	6.4	25.9	4.9	2.4	13.0
LT	Aver.	11	27.6	26.6	27.8	12.2	10.9	12.7	1,101	23.3	18.8	26.5	9.9	6.9	13.0
LU	2005	74	18.8	17.5	13.8	1.6	0.7	4.6	197	25.3	19.7	27.7	9.6	6.6	12.3
LU	2006	79	20.6	18.5	15.2	1.6	0.7	3.9	297	23.0	16.9	26.1	8.7	6.6	11.3
LU	2007	93	19.3	16.9	16.7	1.7	0.7	2.6	337	24.0	17.8	29.5	8.8	6.4	12.4
LU	2008	96	12.5	12.0	18.4	0.9	0.5	2.5	374	18.8	13.2	28.1	8.0	4.8	13.1
LU	2009	100	13.6	12.6	15.5	1.1	0.7	2.9	505	19.7	12.8	27.8	7.8	4.6	12.2
LU	Aver.	88	17.0	15.5	16.0	1.4	0.7	3.4	342	22.1	16.1	27.8	8.6	5.8	12.3

MS	Year	Financial Sector							Non-Financial Sector						
			RoE			RoA				RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd	Number	Mean	Median	Sd	Mean	Median	Sd
LV	2005	19	20.1	15.9	29.4	7.0	2.3	19.4	602	33.1	30.7	28.5	11.3	8.5	11.3
LV	2006	18	12.2	7.2	26.4	4.0	1.1	17.8	690	36.9	34.7	29.3	13.3	10.3	13.8
LV	2007	18	24.3	23.1	27.5	5.7	1.5	11.3	731	36.1	33.0	29.5	13.6	10.3	14.2
LV	2008	21	22.1	20.5	21.9	9.0	2.9	14.3	779	25.0	19.6	29.5	9.0	5.0	13.1
LV	2009	24	13.9	8.8	24.4	2.7	0.8	10.9	766	18.1	10.0	33.1	4.8	2.4	11.6
LV	Aver.	20	18.5	15.1	26.0	5.7	1.7	15.1	714	29.8	25.6	30.0	10.4	7.3	12.8
MT	2005	7	22.8	12.8	21.2	7.9	1.2	8.7	127	7.6	0.0	21.0	3.6	0.0	9.5
MT	2006	8	16.1	11.2	14.6	6.4	1.0	8.9	145	6.7	0.0	18.1	3.2	0.0	8.3
MT	2007	12	22.0	12.5	32.1	11.0	1.1	20.6	171	8.3	0.0	22.1	4.8	0.0	13.5
MT	2008	12	6.9	5.2	25.1	3.1	0.9	13.2	243	8.7	0.0	21.0	4.0	0.0	10.3
MT	2009	13	6.0	2.5	20.0	3.0	0.5	9.5	276	5.4	0.0	16.1	2.6	0.0	8.5
MT	Aver.	10	14.7	8.8	23.4	6.3	1.0	13.0	192	7.4	0.0	19.8	3.6	0.0	10.2
NL	2005	204	17.5	14.5	19.7	6.3	4.0	9.2	3,858	25.3	20.6	28.3	10.1	7.1	12.8
NL	2006	266	15.9	9.3	22.3	7.2	4.0	13.2	4,516	26.5	22.3	28.3	10.5	7.4	13.3
NL	2007	332	12.8	6.0	22.4	5.6	2.9	10.8	5,248	27.5	23.3	28.6	11.3	8.0	13.8
NL	2008	360	-1.3	0.0	27.7	-5.5	0.0	18.3	6,166	23.9	19.3	29.0	10.4	6.9	14.8
NL	2009	461	13.0	8.7	20.0	6.2	3.6	10.6	7,733	20.5	14.8	28.8	9.0	5.4	14.7
NL	Aver.	325	11.6	7.7	22.6	4.0	2.9	12.8	5,504	24.7	20.0	28.6	10.2	6.9	13.9
PL	2005	143	18.4	14.8	25.7	7.5	2.6	16.2	13,842	23.7	18.6	26.5	11.3	7.7	14.3
PL	2006	233	18.7	14.0	26.6	8.4	3.2	17.6	22,818	25.6	20.7	27.1	12.4	8.6	15.0
PL	2007	299	23.3	14.9	30.0	10.8	4.2	18.7	27,003	27.7	22.8	28.0	13.9	9.8	16.1
PL	2008	340	20.7	14.8	28.4	10.4	4.1	18.7	31,560	24.2	18.8	28.5	12.8	8.3	16.8
PL	2009	392	14.6	10.4	26.8	7.3	3.0	17.6	35,350	19.4	13.7	27.2	10.1	6.1	15.9
PL	Aver.	281	19.1	13.8	27.5	8.9	3.4	17.8	26,115	24.1	18.9	27.5	12.1	8.1	15.6
PT	2005	200	18.0	13.0	30.5	7.6	3.5	13.8	130,650	17.0	11.8	26.1	6.9	3.4	13.4
PT	2006	221	18.7	13.9	26.1	7.1	3.5	13.0	138,357	15.7	10.9	25.3	6.4	3.2	12.1
PT	2007	282	21.2	17.2	27.6	8.0	4.8	13.4	149,058	15.4	10.6	25.5	6.3	3.2	12.2
PT	2008	354	15.4	9.4	28.5	6.0	2.3	14.5	161,363	13.3	8.4	25.6	5.5	2.5	12.4
PT	2009	396	17.7	12.1	28.9	6.7	3.3	14.1	181,199	12.7	7.9	25.4	5.2	2.4	12.3
PT	Aver.	291	18.2	13.1	28.4	7.1	3.5	13.8	152,125	14.8	9.9	25.6	6.1	3.0	12.5
RO	2005	499	41.4	44.9	35.2	20.4	13.5	22.7	87,640	36.2	32.9	33.4	16.1	9.4	20.3
RO	2006	627	42.6	42.8	32.9	20.8	16.8	20.8	94,785	36.2	33.3	32.4	16.7	10.0	20.4
RO	2007	958	34.8	28.7	33.7	17.3	11.0	21.5	135,981	32.8	28.2	32.7	15.1	8.2	20.0
RO	2008	1,198	31.4	27.4	34.7	16.6	9.6	22.4	162,205	29.2	23.5	32.5	13.6	6.6	19.9
RO	2009	1,450	25.7	20.2	33.2	13.9	7.6	21.5	184,260	24.4	18.0	32.6	11.4	5.2	19.1
RO	Aver.	946	35.2	32.8	34.0	17.8	11.7	21.8	132,974	31.8	27.2	32.7	14.6	7.9	20.0
SE	2005	1,154	20.0	13.2	29.7	11.6	5.3	19.8	118,074	19.0	14.6	28.7	8.7	5.5	14.9
SE	2006	1,634	23.3	13.7	32.5	15.0	6.2	24.4	163,371	21.9	17.4	29.7	10.2	6.7	15.9

MS	Year	Financial Sector							Non-Financial Sector						
			RoE			RoA				RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd	Number	Mean	Median	Sd	Mean	Median	Sd
SE	2007	1,848	19.7	9.8	32.5	13.3	4.3	24.3	177,112	23.2	18.7	30.8	11.2	7.3	17.2
SE	2008	1,992	16.8	4.1	36.7	11.4	1.7	28.3	190,621	21.5	16.6	31.8	10.6	6.4	18.1
SE	2009	2,434	16.6	6.7	31.7	11.1	2.8	23.4	211,252	19.8	14.4	31.5	9.8	5.4	18.0
SE	Aver.	1,812	19.3	9.5	32.7	12.5	4.1	24.2	172,086	21.1	16.3	30.5	10.1	6.3	16.9
SI	2005	11	7.1	10.3	11.9	1.6	0.8	2.4	650	18.6	14.1	22.8	7.1	4.8	10.1
SI	2006	36	11.4	9.6	25.2	4.2	0.9	10.7	5,298	19.5	14.5	22.5	6.9	4.6	9.6
SI	2007	41	14.7	9.3	22.1	5.2	1.3	9.0	5,588	20.7	15.5	23.0	7.4	4.5	9.8
SI	2008	41	11.0	6.5	28.0	3.4	0.9	11.6	5,827	17.5	12.3	23.0	6.4	3.5	9.9
SI	2009	48	11.9	9.0	27.0	3.9	1.4	7.5	5,983	11.5	7.0	22.2	4.1	2.0	9.1
SI	Aver.	35	11.2	8.9	23.6	3.7	1.0	8.9	4,669	17.5	12.7	22.7	6.4	3.9	9.7
SK	2005	17	11.0	11.3	21.7	3.5	1.2	7.8	2,474	20.6	14.2	27.4	7.6	4.1	12.1
SK	2006	19	17.6	15.1	18.1	7.1	1.2	11.6	3,105	23.6	17.1	28.8	8.7	5.2	13.1
SK	2007	24	20.0	17.7	15.5	5.5	1.9	8.0	3,470	23.2	16.7	28.6	9.1	5.2	14.0
SK	2008	29	13.6	11.6	18.4	4.4	1.9	7.5	2,906	21.0	14.9	26.7	8.7	5.3	13.7
SK	2009	43	17.1	14.2	23.4	8.3	3.8	13.6	6,412	16.0	7.9	29.0	7.3	2.5	16.2
SK	Aver.	26	15.8	14.0	19.6	5.7	2.0	10.0	3,673	20.9	14.2	28.1	8.3	4.5	13.9
UK	2005	3,741	23.3	14.4	29.7	9.6	4.1	16.2	78,116	21.6	13.4	30.5	12.0	5.8	20.8
UK	2006	4,639	23.9	15.1	29.6	10.0	4.6	16.2	101,517	21.1	12.9	30.2	11.7	5.6	20.3
UK	2007	5,215	24.1	14.9	30.0	9.9	5.0	16.2	113,267	21.1	12.8	30.3	11.8	5.6	20.4
UK	2008	5,781	21.7	13.2	30.8	8.6	3.9	16.7	124,407	19.5	11.2	31.0	11.0	4.8	20.8
UK	2009	6,624	19.6	10.5	30.6	8.0	2.9	16.8	147,927	19.1	10.3	31.7	10.5	4.1	21.3
UK	Aver.	5,200	22.5	13.6	30.1	9.2	4.1	16.4	113,047	20.5	12.1	30.7	11.4	5.2	20.7

Source: Orbis and own computations.

Next, we investigate the skewness of the sector. A first observation is that the skewness is in most cases positive with an average of 0.76 for RoE and 1.66 for RoA. As stated above, this indicates that most of the observations are concentrated on the left and that there are a few outliers that enjoy very high profitability. The skewness (for RoE) is strictly higher than the one in the non-financial sector in 60% of the country-year pairs (it is a tie in 6% of the cases). This figure had actually a tendency to gradually decline over time from 67% to 52% between 2005 and 2009. The skewness of the RoE and RoA distributions for the non-financial sector was on average 0.62 and 0.50 respectively.

We therefore identified that the financial sector contains a few highly-profitable outliers. The question is how often it is the case. The average kurtosis for the financial sector is 1.86 for RoE and 10.01 for RoA, to be compared to 1.49 and 4.82 for the non-financial sector. This indicates that there are more extreme high-profitability cases in the financial sector. The figure is particularly high in Germany and Luxembourg.

Table (1b): Skewness and Kurtosis in the profitability distributions.

MS	Year	Financial Sector					Non-Financial Sector				
			RoE		RoA			RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis	Number	Skewness	Kurtosis	Skewness	Kurtosis
AT	2005	211	1.6	7.3	6.4	69.5	86	0.7	1.6	0.7	3.4
AT	2006	224	1.5	2.8	8.9	20.5	370	0.8	1.4	0.3	3.6
AT	2007	225	2.3	9.0	9.8	104.4	398	0.3	1.3	0.1	4.4
AT	2008	230	0.8	3.0	12.1	25.0	616	0.7	1.3	0.8	3.3
AT	2009	234	1.3	3.0	8.4	25.9	1,090	0.8	1.8	1.2	7.4
AT	Aver.	225	1.5	5.0	9.1	49.1	512	0.6	1.5	0.6	4.4
BE	2005	3,012	1.0	1.8	1.6	6.5	169,247	0.7	1.4	0.7	4.8
BE	2006	3,547	1.2	1.8	1.8	7.5	202,684	0.7	1.5	0.8	4.9
BE	2007	3,718	1.2	2.0	1.8	7.1	218,085	0.7	1.4	0.7	4.7
BE	2008	3,923	1.2	1.8	1.9	7.0	233,817	0.7	1.4	0.7	4.7
BE	2009	4,154	1.1	1.8	1.8	6.6	253,916	0.7	1.4	0.7	4.7
BE	Aver.	3,671	1.1	1.9	1.8	6.9	215,550	0.7	1.4	0.7	4.8
BG	2005	105	0.6	3.0	0.7	12.1	7,083	0.4	1.9	-0.4	5.3
BG	2006	148	0.8	2.5	0.9	7.8	12,152	0.4	1.9	-0.5	5.0
BG	2007	226	0.6	2.0	0.1	4.7	17,837	0.2	1.6	-0.6	2.9
BG	2008	238	0.5	1.6	0.0	4.4	21,756	0.4	1.5	-0.2	2.9
BG	2009	280	0.9	1.8	0.9	5.3	25,780	0.7	1.6	1.0	5.2
BG	Aver.	199	0.7	2.2	0.5	6.9	16,922	0.4	1.7	-0.2	4.3
CY	2005	4	0.4	-0.2	-1.1	-1.6	5	-0.5	1.0	-1.5	-0.4
CY	2006	5	0.3	0.7	-1.5	-0.6	6	-0.9	-0.7	0.0	-0.1
CY	2007	6	-1.0	-0.7	-0.4	-0.5	10	1.1	1.9	0.0	2.7
CY	2008	7	-1.2	-2.0	0.3	2.1	10	-0.6	0.1	-1.1	-0.9
CY	2009	7	0.7	2.0	-0.9	2.1	12	-0.1	1.7	-1.3	2.6
CY	Aver.	6	-0.2	0.0	-0.8	0.3	9	-0.2	0.8	-0.8	0.8
CZ	2005	144	1.0	3.3	1.4	15.4	22,543	0.8	1.5	0.6	4.5
CZ	2006	171	0.8	1.9	1.5	7.5	28,633	0.8	1.4	0.4	4.0
CZ	2007	192	1.1	2.2	1.7	5.3	34,236	0.8	1.4	0.4	3.9
CZ	2008	202	0.9	2.3	1.6	7.2	40,101	0.9	1.5	0.8	4.5
CZ	2009	224	0.8	1.6	0.6	3.9	46,662	1.1	1.6	1.6	6.0
CZ	Aver.	187	0.9	2.2	1.4	7.8	34,435	0.9	1.5	0.8	4.6
DE	2005	2,000	1.7	5.9	11.2	60.0	16,430	0.6	1.6	0.3	5.9
DE	2006	2,062	2.7	6.2	15.2	58.0	20,933	0.6	1.5	0.2	5.3
DE	2007	2,106	2.9	10.3	16.4	170.2	22,746	0.5	1.4	0.1	4.5
DE	2008	2,159	2.5	4.5	15.3	41.6	30,541	0.5	1.5	0.1	4.6
DE	2009	2,197	2.7	6.5	16.2	81.4	33,723	0.6	1.5	0.4	5.3
DE	Aver.	2,105	2.5	6.7	14.9	82.2	24,875	0.6	1.5	0.2	5.1
DK	2005	6,196	1.0	1.5	1.2	3.5	51,326	0.4	1.3	-0.1	2.7
DK	2006	10,121	1.2	1.8	1.5	4.4	86,040	0.5	1.3	-0.2	2.7

MS	Year	Financial Sector					Non-Financial Sector				
			RoE		RoA			RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis	Number	Skewness	Kurtosis	Skewness	Kurtosis
DK	2007	11,731	1.2	1.8	1.8	4.4	99,580	0.5	1.3	-0.1	2.4
DK	2008	11,949	1.1	1.2	2.1	3.9	110,360	0.6	1.0	0.0	2.4
DK	2009	13,725	1.1	1.3	2.6	4.9	124,486	0.7	1.1	0.6	3.3
DK	Aver.	10,744	1.1	1.5	1.8	4.2	94,358	0.5	1.2	0.0	2.7
EE	2005	590	0.5	1.3	-0.5	1.6	31,534	0.4	1.0	-0.3	1.5
EE	2006	771	0.6	1.5	-0.5	2.2	36,557	0.4	1.0	-0.5	1.2
EE	2007	920	0.9	1.6	0.2	3.2	41,883	0.4	1.0	-0.4	1.2
EE	2008	866	0.9	1.5	0.7	3.3	45,618	0.6	1.1	0.0	1.8
EE	2009	1,120	1.0	1.7	0.7	4.8	49,539	0.8	1.3	0.5	2.7
EE	Aver.	853	0.8	1.5	0.1	3.0	41,026	0.5	1.1	-0.1	1.7
EL	2005	64	0.6	1.6	1.3	3.4	14,866	1.1	1.2	1.6	6.3
EL	2006	71	0.6	1.0	2.4	3.9	16,275	1.0	1.3	1.3	6.7
EL	2007	75	0.8	2.0	1.2	6.4	17,067	0.9	1.3	1.0	5.4
EL	2008	77	0.6	1.2	0.9	6.8	18,484	1.0	1.4	1.2	6.1
EL	2009	81	0.6	1.0	0.8	4.5	19,468	1.0	1.2	1.7	6.1
EL	Aver.	74	0.6	1.4	1.3	5.0	17,232	1.0	1.3	1.4	6.1
ES	2005	1,761	0.9	1.9	1.1	8.1	279,692	0.8	2.0	1.3	8.5
ES	2006	1,922	0.9	1.5	1.2	5.8	307,648	0.8	2.0	1.2	8.4
ES	2007	1,815	0.8	1.6	0.9	6.0	310,903	0.9	1.9	1.3	7.9
ES	2008	2,808	0.8	1.2	1.2	6.0	384,246	0.9	1.7	1.9	8.3
ES	2009	3,116	1.0	1.7	2.1	7.3	404,546	0.9	1.6	2.4	9.3
ES	Aver.	2,284	0.9	1.6	1.3	6.6	337,407	0.9	1.8	1.6	8.5
FI	2005	880	0.9	1.4	0.9	3.3	44,267	0.3	0.8	-0.2	1.4
FI	2006	1,063	1.0	1.6	0.7	3.4	57,373	0.3	0.8	-0.1	1.5
FI	2007	1,687	1.0	1.7	1.1	4.0	75,073	0.4	0.9	-0.1	1.7
FI	2008	2,099	1.0	1.6	1.0	3.6	87,900	0.5	0.9	0.1	2.1
FI	2009	2,515	1.1	1.7	1.5	4.6	98,575	0.6	1.0	0.4	2.8
FI	Aver	1,649	1.0	1.6	1.0	3.8	72,638	0.4	0.9	0.0	1.9
FR	2005	3,922	0.9	1.7	0.8	5.6	382,336	0.4	1.4	-0.2	3.9
FR	2006	4,791	0.9	1.7	0.7	5.1	466,651	0.3	1.4	-0.2	3.8
FR	2007	5,545	0.9	1.7	0.6	5.3	521,123	0.3	1.3	-0.3	3.6
FR	2008	6,360	0.8	1.4	0.7	4.5	578,152	0.3	1.3	-0.2	3.6
FR	2009	7,492	0.9	1.7	1.0	5.9	655,703	0.4	1.3	-0.1	3.9
FR	Aver	5,622	0.9	1.6	0.8	5.3	520,793	0.4	1.3	-0.2	3.8
HU	2005	512	0.4	0.6	0.2	1.8	115,363	0.6	1.1	0.5	2.7
HU	2006	241	0.5	0.7	0.5	1.0	46,339	0.7	1.2	0.8	3.9
HU	2007	476	0.5	0.7	0.2	2.1	98,866	0.7	1.2	0.6	3.3
HU	2008	569	0.5	0.8	0.0	1.4	108,357	0.7	1.1	0.5	3.0

MS	Year	Financial Sector					Non-Financial Sector				
			RoE		RoA			RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis	Number	Skewness	Kurtosis	Skewness	Kurtosis
HU	2009	1,035	0.6	1.0	0.2	2.4	203,419	0.7	1.2	0.6	3.2
HU	Aver	567	0.5	0.8	0.2	1.7	114,469	0.7	1.1	0.6	3.2
IE	2005	186	1.1	3.1	1.5	13.5	4,730	0.8	1.6	0.7	4.2
IE	2006	212	0.8	1.8	1.1	4.7	5,400	0.7	1.6	0.6	4.4
IE	2007	294	0.9	2.9	0.9	14.0	6,237	0.8	1.6	0.7	4.1
IE	2008	344	1.2	1.7	1.4	5.3	7,166	0.8	1.6	0.9	4.8
IE	2009	459	0.9	2.6	1.2	11.2	9,066	1.0	1.7	1.0	5.1
IE	Aver	299	1.0	2.4	1.2	9.8	6,520	0.8	1.6	0.8	4.5
IT	2005	1,953	1.2	3.2	2.3	18.1	291,491	0.4	2.2	-0.1	10.5
IT	2006	2,137	1.2	3.0	2.1	15.4	322,930	0.4	2.3	-0.3	10.1
IT	2007	4,202	1.2	2.6	2.5	13.2	494,947	0.5	1.7	-0.2	8.4
IT	2008	4,456	1.3	2.6	2.7	13.7	554,326	0.6	1.8	0.1	9.2
IT	2009	4,834	1.3	2.6	2.9	15.9	628,180	0.6	1.6	0.2	9.2
IT	Aver	3,516	1.2	2.8	2.5	15.3	458,375	0.5	1.9	0.0	9.5
LT	2005	8	0.6	0.4	-0.5	-1.3	878	0.5	1.1	0.4	3.0
LT	2006	11	0.6	1.1	-1.0	0.8	1,003	0.5	1.4	0.1	3.1
LT	2007	11	-0.4	-0.4	-0.1	-0.7	1,055	0.4	1.2	0.3	2.4
LT	2008	11	0.9	0.5	-0.5	-1.6	1,262	0.6	1.3	0.3	3.3
LT	2009	12	-0.2	0.5	-1.1	0.1	1,308	0.9	1.5	1.4	6.2
LT	Aver	11	0.3	0.4	-0.7	-0.5	1,101	0.6	1.3	0.5	3.6
LU	2005	74	0.8	7.2	2.8	54.6	197	0.7	1.3	0.0	4.9
LU	2006	79	0.0	4.2	2.9	31.1	297	0.7	1.4	0.3	4.3
LU	2007	93	0.1	1.7	3.7	3.4	337	0.6	1.2	0.3	4.6
LU	2008	96	0.5	3.2	3.4	19.9	374	0.6	1.6	0.6	6.1
LU	2009	100	0.0	-1.8	3.6	19.4	505	0.7	1.3	0.2	3.6
LU	Aver	88	0.3	2.9	3.3	25.7	342	0.7	1.3	0.3	4.7
LV	2005	19	0.0	1.5	-0.5	2.1	602	0.2	0.9	-0.4	0.9
LV	2006	18	0.0	1.0	-0.5	2.5	690	0.2	1.3	-0.5	2.8
LV	2007	18	0.4	2.3	0.5	4.9	731	0.2	1.4	-0.5	2.3
LV	2008	21	1.4	1.6	2.6	0.9	779	0.5	1.3	-0.2	3.4
LV	2009	24	0.9	-0.2	1.7	3.8	766	0.5	1.5	-0.2	5.5
LV	Aver	20	0.6	1.2	0.8	2.8	714	0.3	1.3	-0.4	3.0
MT	2005	7	0.5	0.5	-1.3	-1.5	127	1.9	2.4	5.3	6.5
MT	2006	8	0.3	1.4	-1.6	0.8	145	1.5	1.6	4.5	4.5
MT	2007	12	0.8	1.0	0.2	0.3	171	1.5	4.4	3.8	24.2
MT	2008	12	0.0	1.1	0.3	1.4	243	2.3	3.2	5.9	14.6
MT	2009	13	0.0	0.7	-0.5	1.1	276	1.9	3.1	5.9	14.2
MT	Aver	10	0.3	1.0	-0.6	0.4	192	1.8	2.9	5.1	12.8

MS	Year	Financial Sector					Non-Financial Sector				
			RoE		RoA			RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis	Number	Skewness	Kurtosis	Skewness	Kurtosis
NL	2005	204	0.5	1.3	1.4	7.7	3,858	0.4	1.4	0.0	4.2
NL	2006	266	1.5	3.0	3.1	13.6	4,516	0.4	1.4	-0.1	4.3
NL	2007	332	1.3	2.9	3.2	12.1	5,248	0.4	1.2	-0.1	3.4
NL	2008	360	0.8	0.1	1.2	2.5	6,166	0.4	1.3	0.0	4.3
NL	2009	461	1.4	2.6	3.0	12.9	7,733	0.6	1.6	0.3	5.3
NL	Aver	325	1.1	1.9	2.4	9.7	5,504	0.5	1.4	0.0	4.3
PL	2005	143	0.2	1.3	-0.2	3.0	13,842	0.6	1.4	0.3	3.5
PL	2006	233	0.6	1.2	0.4	3.0	22,818	0.6	1.3	0.1	2.9
PL	2007	299	0.8	1.5	0.0	2.9	27,003	0.5	1.3	-0.1	2.6
PL	2008	340	0.6	1.5	0.1	3.0	31,560	0.5	1.3	0.1	2.6
PL	2009	392	0.5	1.1	0.6	3.5	35,350	0.7	1.4	0.7	3.8
PL	Aver	281	0.5	1.3	0.2	3.1	26,115	0.6	1.3	0.2	3.1
PT	2005	200	0.6	1.9	0.4	4.7	130,650	0.7	2.6	1.0	12.2
PT	2006	221	0.7	1.8	0.7	7.0	138,357	0.7	1.9	1.1	7.7
PT	2007	282	0.5	1.8	0.3	6.1	149,058	0.7	1.9	1.1	7.6
PT	2008	354	0.7	0.7	0.6	2.9	161,363	0.8	1.9	1.2	8.1
PT	2009	396	0.6	0.8	0.5	3.6	181,199	0.8	1.9	1.3	8.3
PT	Aver	291	0.6	1.4	0.5	4.9	152,125	0.7	2.0	1.1	8.8
RO	2005	499	-0.2	0.8	-1.0	0.2	87,640	0.1	1.4	-0.8	1.9
RO	2006	627	-0.1	0.8	-0.9	0.3	94,785	0.1	1.3	-0.8	1.6
RO	2007	958	0.2	1.2	-0.8	1.5	135,981	0.2	1.3	-0.7	1.9
RO	2008	1,198	0.2	0.9	-0.8	0.7	162,205	0.3	1.4	-0.6	2.1
RO	2009	1,450	0.3	1.0	-0.5	1.2	184,260	0.4	1.4	-0.4	2.5
RO	Aver	946	0.1	0.9	-0.8	0.8	132,974	0.2	1.4	-0.7	2.0
SE	2005	1,154	0.8	2.0	0.4	5.1	118,074	0.5	1.4	0.2	4.7
SE	2006	1,634	0.8	1.7	-0.1	3.0	163,371	0.4	1.4	0.0	4.4
SE	2007	1,848	0.8	1.8	0.2	3.2	177,112	0.4	1.4	-0.2	4.0
SE	2008	1,992	0.8	1.5	-0.2	2.0	190,621	0.4	1.3	-0.3	3.6
SE	2009	2,434	0.9	1.8	0.4	3.6	211,252	0.4	1.3	-0.2	3.5
SE	Aver	1,812	0.8	1.7	0.2	3.4	172,086	0.4	1.4	-0.1	4.1
SI	2005	11	-1.1	1.2	0.5	0.7	650	0.8	2.3	1.4	11.6
SI	2006	36	1.0	1.7	2.8	4.3	5,298	0.8	1.8	1.2	8.5
SI	2007	41	1.2	1.8	2.1	2.6	5,588	0.9	1.9	1.0	6.7
SI	2008	41	0.9	-1.2	1.3	7.7	5,827	0.9	2.1	1.6	9.1
SI	2009	48	0.8	0.5	2.0	1.2	5,983	1.0	2.0	2.6	10.9
SI	Aver	35	0.6	0.8	1.8	3.3	4,669	0.9	2.0	1.6	9.4
SK	2005	17	-0.7	2.0	1.0	4.2	2,474	0.7	1.4	0.2	3.7
SK	2006	19	0.8	1.8	-0.1	1.6	3,105	0.6	1.5	0.0	4.3

MS	Year	Financial Sector					Non-Financial Sector				
			RoE		RoA			RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis	Number	Skewness	Kurtosis	Skewness	Kurtosis
SK	2007	24	0.4	2.5	-0.3	6.4	3,470	0.6	1.6	0.1	4.8
SK	2008	29	0.0	0.3	0.7	0.7	2,906	0.7	1.5	0.3	5.2
SK	2009	43	0.2	1.4	1.3	3.9	6,412	0.8	1.8	0.5	4.8
SK	Aver	26	0.1	1.6	0.5	3.4	3,673	0.7	1.6	0.2	4.6
UK	2005	3,741	0.8	2.1	0.1	6.2	78,116	0.7	1.7	0.2	4.2
UK	2006	4,639	0.7	1.8	0.0	5.2	101,517	0.7	1.6	0.2	4.2
UK	2007	5,215	0.7	1.7	-0.1	4.6	113,267	0.7	1.6	0.2	4.0
UK	2008	5,781	0.6	1.6	-0.1	4.8	124,407	0.7	1.5	0.2	3.8
UK	2009	6,624	0.7	1.9	0.1	6.1	147,927	0.8	1.6	0.2	4.1
UK	Aver	5,200	0.7	1.8	0.0	5.4	113,047	0.7	1.6	0.2	4.1

Source: Orbis and own computations.

6.21. Profitability in the financial sector by size of the assets.

Next, we look at profitability of the financial sector by size of financial companies. The financial sector ranges indeed from local insurance retailers to large banking multinationals.

The size is defined by total assets. The categories are the following: (1) lowest quartile: total assets up to EUR 2.634 million, (2) second quartile: total assets from EUR 2.634 million to EUR 199.7 million, (3) third quartile: total assets from EUR 199.7 million to EUR 807.5 million, (4) category 75-90: total assets from EUR 807.5 million to EUR 2,381.1 million, (5) category 90-95: total assets from EUR 2,381.1 million to EUR 5,047.5 million (6) category 95-99: total assets from EUR 5,047.5 million to EUR 37,400 million, and (7) top 1%: total assets over EUR 37,400 million.

Table (2a): Mean and Median Profitability across size (total assets).

Size	Year	Financial Sector						
			RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd
Low quartl 0-25	2005	788	10.4	8.5	10.6	1.3	1.0	2.7
	2006	788	11.4	10.3	9.8	1.5	1.2	3.2
	2007	725	12.1	10.7	11.5	1.6	1.3	4.4
	2008	791	8.7	8.1	10.0	1.1	0.9	2.9
	2009	822	6.6	5.7	10.8	1.0	0.6	3.0
	Aver	783	9.9	8.6	10.6	1.3	1.0	3.3
Quart 25-50	2005	730	12.3	9.5	13.2	1.3	0.7	3.7
	2006	773	10.8	8.8	12.3	1.1	0.7	3.4
	2007	791	10.1	7.9	12.5	1.1	0.6	4.0
	2008	806	7.2	5.6	13.7	0.7	0.4	4.5

Size	Year	Financial Sector						
			RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd
	2009	814	8.2	7.1	13.4	1.0	0.5	4.3
	Aver	783	9.7	7.8	13.0	1.0	0.6	4.0
Quart 50-75	2005	772	10.4	9.0	8.5	0.9	0.6	1.9
	2006	782	8.8	7.7	7.8	0.7	0.5	1.3
	2007	775	7.8	6.7	7.2	0.7	0.5	1.9
	2008	789	4.8	4.4	9.3	0.4	0.3	2.8
	2009	796	7.8	7.7	8.7	0.6	0.5	1.3
	Aver	783	8.0	7.1	8.3	0.7	0.5	1.9
Size 75-90	2005	430	10.2	9.1	8.8	0.9	0.5	1.8
	2006	446	8.5	7.6	8.7	0.9	0.4	3.0
	2007	467	8.0	6.7	7.9	0.7	0.4	2.3
	2008	494	5.5	4.5	10.3	0.3	0.3	3.3
	2009	512	7.9	6.9	9.9	0.8	0.4	3.9
	Aver	470	8.0	7.0	9.2	0.7	0.4	2.9
Size 90-95	2005	139	10.9	10.0	9.5	0.9	0.5	2.0
	2006	152	10.2	8.8	8.2	0.8	0.4	1.4
	2007	165	9.7	7.2	13.4	0.7	0.4	1.2
	2008	166	5.3	4.7	8.0	0.3	0.2	0.7
	2009	162	6.6	7.0	7.5	0.4	0.4	0.6
	Aver	157	8.6	7.5	9.6	0.6	0.4	1.3
Size 95-99	2005	111	11.6	9.0	12.6	0.7	0.4	0.9
	2006	123	12.4	8.8	15.6	0.8	0.4	1.3
	2007	127	10.1	7.2	12.0	0.7	0.4	1.5
	2008	133	5.3	3.4	13.2	0.4	0.2	1.6
	2009	131	8.2	6.2	13.2	0.5	0.4	1.3
	Aver	125	9.5	6.9	13.4	0.6	0.4	1.4
Top 1%	2005	24	11.0	8.8	11.0	0.7	0.4	1.0
	2006	28	11.1	10.1	10.3	0.6	0.4	1.0
	2007	30	12.5	9.4	12.3	0.5	0.3	0.7
	2008	37	12.7	9.0	17.2	0.5	0.3	0.9
	2009	38	12.2	7.4	14.2	0.5	0.3	0.6
	Aver	31	11.9	8.9	13.2	0.6	0.3	0.8

Source: Orbis and own computations.

Interestingly, we observe a form of U-shape function. Very small and very large companies are on average more profitable than middle-size companies in the financial sector. Skewness and Kurtosis show inverted U-shape relationships with size, indicating that groups of very small and very large companies are more uniforms in terms of profitability (which is on average higher) and

that the proportion of highly-profitable outliers and their distance to the mean profitability is larger for middle-size companies.

Table (2b): Skewness and Kurtosis in the profitability distributions across size (total assets).

Size	Year	Financial Sector	RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis
Low quartl 0-25	2005	788	1.8	8.9	10.0	137.6
	2006	788	1.5	12.2	8.9	133.0
	2007	725	2.4	16.7	17.0	359.9
	2008	791	1.5	11.9	10.1	150.3
	2009	822	1.1	11.7	11.0	151.0
	Aver	783	1.7	12.3	11.4	186.4
Quart 25-50	2005	730	2.5	12.3	7.3	61.1
	2006	773	1.9	10.4	4.5	58.1
	2007	791	1.6	9.2	3.1	73.3
	2008	806	1.3	9.6	5.7	79.3
	2009	814	2.1	14.6	4.4	47.3
	Aver	783	1.9	11.2	5.0	63.8
Quart 50-75	2005	772	1.5	12.0	8.4	87.2
	2006	782	3.3	32.8	7.3	81.0
	2007	775	2.7	16.7	13.7	224.9
	2008	789	2.2	30.0	3.3	193.8
	2009	796	1.8	22.1	8.1	114.1
	Aver	783	2.3	22.7	8.1	140.2
Size 75-90	2005	430	1.4	11.0	7.7	74.5
	2006	446	3.3	25.5	11.2	152.6
	2007	467	3.7	23.1	8.9	142.6
	2008	494	2.4	22.3	-0.8	115.9
	2009	512	2.6	15.6	12.1	172.3
	Aver	470	2.7	19.5	7.8	131.6
Size 90-95	2005	139	1.4	11.0	7.6	74.5
	2006	152	1.6	25.5	5.2	152.6
	2007	165	3.8	23.1	5.6	142.6
	2008	166	0.2	22.3	-1.3	115.9
	2009	162	-2.8	15.6	-1.6	172.3
	Aver	157	0.8	19.5	3.1	131.6
Size 95-99	2005	111	2.8	11.2	3.3	15.4
	2006	123	2.3	9.8	3.9	19.7
	2007	127	1.6	5.2	7.2	63.9
	2008	133	-0.6	4.6	5.0	46.0

Size	Year	Financial Sector	RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis
	2009	131	1.1	8.0	6.1	55.8
	Aver	125	1.4	7.8	5.1	40.2
Top 1%	2005	24	0.4	0.3	2.5	5.8
	2006	28	1.7	3.3	3.4	12.2
	2007	30	1.2	1.0	2.6	8.0
	2008	37	1.2	1.0	1.7	4.4
	2009	38	1.2	1.4	0.9	0.4
	Aver	31	1.1	1.4	2.2	6.1

Source: Orbis and own computations.

6.3. Profitability across segments of the financial sector.

The financial sector is not uniform either in terms of its activities. Therefore we also look at profitability in various segments of the financial sector. The segments are: commercial banks, savings banks, cooperative banks, real estate and mortgage banks, investment banking, Islamic banks, Government-sponsored companies (Specialised Governmental Credit Institutions), central banks and multilateral government banks, investment and trust corporations, finance companies (credit card, factoring and leasing)[1].

Table (3a): Mean and Median Profitability across segments.

Size	Year	Financial Sector						
			RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd
Islamic banks	2005	1	-15.8	-15.8	0.0	-7.2	-7.2	0.0
	2006	1	-27.8	-27.8	0.0	-7.5	-7.5	0.0
	2007	1	-27.8	-27.8	0.0	-4.2	-4.2	0.0
	2008	1	-31.2	-31.2	0.0	-3.3	-3.3	0.0
	2009	0	n.a.	n.a.	n.a.	n.a.	n.a.	0.0
	Aver	1	-25.6	-25.6	0.0	-5.5	-5.5	0.0
Government-sponsored companies	2005	26	9.4	5.9	13.3	2.1	0.5	3.5
	2006	27	6.3	6.2	6.2	2.0	0.7	4.4
	2007	29	6.9	5.7	6.4	1.9	0.6	3.2
	2008	32	4.9	3.9	4.3	1.1	0.4	1.6
	2009	32	4.1	2.7	8.0	0.8	0.2	1.6

[1] These categories are defined in Orbis. There was no usable information for the following categories: Other non banking credit institutions, bank holding and holding companies, micro-financing institutions, securities firms, private banking and asset management companies, clearing institutions and custody, group finance company. We also excluded insurances here.

Size	Year	Financial Sector						
			RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd
	Aver	29	6.3	4.9	8.2	1.6	0.5	3.1
Savings Banks	2005	592	10.0	9.3	6.8	0.8	0.5	0.9
	2006	596	8.6	8.2	5.2	0.7	0.5	0.7
	2007	603	7.2	6.7	4.9	0.6	0.4	0.6
	2008	627	3.5	3.8	7.4	0.2	0.2	0.7
	2009	630	6.7	6.5	7.2	0.5	0.4	0.5
	Aver	610	7.2	6.9	6.4	0.6	0.4	0.7
Estate and mortgage	2005	77	10.0	9.2	7.9	1.0	0.4	4.2
	2006	87	8.0	7.2	6.3	0.5	0.4	0.7
	2007	88	8.5	7.4	6.1	0.5	0.4	1.0
	2008	94	4.7	5.0	9.8	0.3	0.2	0.7
	2009	94	7.1	5.6	8.3	0.7	0.4	1.6
	Aver	88	7.7	6.9	7.8	0.6	0.4	2.1
Investment and Trusts	2005	27	19.9	17.3	18.9	12.6	12.5	12.2
	2006	33	13.9	10.5	20.3	9.3	9.3	12.8
	2007	33	9.2	8.8	15.9	4.9	5.7	13.0
	2008	29	-0.1	3.2	27.0	-4.9	0.0	17.2
	2009	34	14.8	12.8	19.4	9.5	9.0	11.0
	Aver	31	11.5	10.5	20.6	6.3	7.3	13.4
Cooperative banks	2005	1,531	9.5	8.6	6.6	0.8	0.6	0.7
	2006	1,554	8.5	8.4	5.1	0.7	0.7	0.6
	2007	1,510	8.0	7.7	4.1	0.7	0.6	0.6
	2008	1,583	5.8	5.6	4.4	0.5	0.4	0.6
	2009	1,585	6.8	7.0	5.4	0.5	0.5	0.7
	Aver	1,553	7.7	7.5	5.2	0.6	0.6	0.6
Commercial banks	2005	598	12.7	11.0	13.8	1.3	0.9	2.8
	2006	633	13.2	11.2	14.3	1.4	0.9	3.7
	2007	632	13.2	11.1	15.0	1.2	0.9	3.1
	2008	651	9.4	8.2	16.6	1.0	0.6	4.3
	2009	700	7.4	6.3	16.3	0.9	0.6	4.5
	Aver	643	11.2	9.5	15.3	1.2	0.8	3.7
Investment and Trusts	2005	27	19.9	17.3	18.9	12.6	12.5	12.2
	2006	33	13.9	10.5	20.3	9.3	9.3	12.8
	2007	33	9.2	8.8	15.9	4.9	5.7	13.0
	2008	29	-0.1	3.2	27.0	-4.9	0.0	17.2
	2009	34	14.8	12.8	19.4	9.5	9.0	11.0
	Aver	31	11.5	10.5	20.6	6.3	7.3	13.4
-month	2005	41	14.5	12.5	22.8	3.6	0.6	7.6

Size	Year	Financial Sector						
			RoE			RoA		
		Number	Mean	Median	Sd	Mean	Median	Sd
	2006	48	17.8	14.4	19.6	3.2	0.7	5.8
	2007	52	20.5	15.9	19.6	4.1	1.3	6.3
	2008	55	11.2	12.9	19.7	2.1	0.6	7.6
	2009	58	13.5	11.4	19.1	3.1	1.0	8.2
	Aver	51	15.5	13.4	20.2	3.2	0.8	7.2
Central banks and int'l financial institutions	2005	22	15.9	9.7	21.9	0.9	0.8	0.8
	2006	22	16.2	11.4	16.5	0.8	0.6	1.0
	2007	21	18.0	15.1	19.5	0.8	0.9	0.7
	2008	22	17.6	16.5	15.4	0.9	0.8	0.8
	2009	25	22.1	12.4	18.1	1.1	0.8	0.7
	Aver	22	18.0	13.0	18.4	0.9	0.8	0.8
Credit cards, factoring and leasing	2005	79	26.6	23.6	25.9	2.6	1.3	5.8
	2006	91	23.0	18.6	25.8	2.2	1.1	6.0
	2007	111	22.5	17.3	27.3	3.9	1.1	11.9
	2008	122	18.6	13.7	23.0	3.0	0.8	8.2
	2009	117	18.1	12.3	21.8	2.3	0.9	6.7
	Aver	104	21.8	17.1	24.8	2.8	1.0	8.1

Source: Orbis and own computations.

As shown in table (3a), profitability varies widely across segments. Savings and mortgage banks are found to be less profitable than investment banks and credit cards, factoring and leasing companies. Compared to the average of the sector at 0.76, skewness is found to be even higher in government-sponsored companies, savings banks and central banks, which are on average with the exception of the latter less profitable than the average firm in the sector. In terms of kurtosis, compared to an average of 1.86 for the sector, the extent to which outliers are further than the average for the sector seems to be negatively linked to profitability. In other words, major highly-profitable outliers seem to be more concentrated in less profitable segments of the financial industry, in particular in savings banks.

Table (3b): Skewness and Kurtosis in the profitability distributions across segments.

Size	Year	Financial Sector				
			RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis
Islamic banks	2005	1	n.a.	n.a.	n.a.	n.a.
	2006	1	n.a.	n.a.	n.a.	n.a.
	2007	1	n.a.	n.a.	n.a.	n.a.
	2008	1	n.a.	n.a.	n.a.	n.a.
	2009	0	n.a.	n.a.	n.a.	n.a.
	Aver	1	n.a.	n.a.	n.a.	n.a.

Size	Year	Financial Sector				
			RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis
Government-sponsored companies	2005	26	2.9	8.7	2.0	2.7
	2006	27	1.1	0.9	3.4	11.4
	2007	29	1.2	1.3	2.5	6.3
	2008	32	0.6	-0.8	1.9	2.8
	2009	32	2.4	7.9	1.4	1.6
	Aver	29	1.6	3.6	2.2	5.0
Savings Banks	2005	592	2.3	15.4	2.7	7.9
	2006	596	1.2	15.8	2.6	9.2
	2007	603	0.7	4.9	2.2	6.5
	2008	627	-2.0	14.6	-1.4	13.8
	2009	630	6.7	90.2	1.8	16.1
	Aver	610	1.8	28.2	1.6	10.7
Estate and mortgage	2005	77	2.0	8.9	8.4	69.9
	2006	87	0.1	1.7	2.8	10.6
	2007	88	0.9	0.9	7.6	63.3
	2008	94	-1.7	9.9	1.2	8.2
	2009	94	1.1	4.3	5.2	28.4
	Aver	88	0.5	5.1	5.0	36.1
Cooperative banks	2005	1,531	1.2	6.2	4.0	63.8
	2006	1,554	-0.5	7.8	2.5	26.6
	2007	1,510	-0.6	7.3	-4.5	73.5
	2008	1,583	-1.6	13.1	2.1	67.0
	2009	1,585	-2.2	16.4	-14.2	383.0
	Aver	1,553	-0.7	10.2	-2.0	122.8
Commercial banks	2005	598	0.7	3.1	6.5	66.4
	2006	633	0.6	2.9	5.0	62.1
	2007	632	0.9	4.0	5.9	76.1
	2008	651	0.9	5.7	7.6	107.8
	2009	700	0.8	5.0	6.8	91.0
	Aver	643	0.8	4.1	6.4	80.7
Investment and Trusts	2005	27	1.1	0.7	0.7	-0.4
	2006	33	1.7	5.2	0.7	4.3
	2007	33	-0.6	4.0	-1.4	6.0
	2008	29	0.8	1.0	0.4	0.5
	2009	34	1.7	4.7	0.7	0.7
	Aver	31	0.9	3.1	0.2	2.2
Investment banking	2005	41	0.6	1.4	2.9	9.4
	2006	48	1.1	1.8	2.5	7.5

Size	Year	Financial Sector				
			RoE		RoA	
		Number	Skewness	Kurtosis	Skewness	Kurtosis
	2007	52	0.4	-0.4	1.8	2.3
	2008	55	-0.2	1.0	-1.0	9.5
	2009	58	0.3	2.6	3.1	11.6
	Aver	51	0.4	1.3	1.8	8.0
Central banks and int'l financial institutions	2005	22	2.5	7.2	1.0	0.7
	2006	22	1.2	0.6	1.0	3.5
	2007	21	0.6	0.3	0.1	-0.6
	2008	22	0.9	0.3	0.8	0.0
	2009	25	0.9	-0.4	0.9	0.5
	Aver	22	1.2	1.6	0.8	0.8
Credit cards, factoring and leasing	2005	79	0.7	1.0	5.1	29.1
	2006	91	1.0	1.4	5.2	30.4
	2007	111	0.7	0.5	5.7	37.9
	2008	122	0.7	0.6	4.3	18.5
	2009	117	1.0	1.2	5.2	28.2
	Aver	104	0.8	1.0	5.1	28.8

Source: Orbis and own computations.

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IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

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ANNEX 7

POLICY OPTIONS

1. POLICY OPTION 1: FINANCIAL TRANSACTION TAX

Box (1). Key terms and concepts

Algorithmic trading: Automated transactions where a computer algorithm decides the order-submission strategy. See also: High-frequency trading. (King and Rime (2010))

Capital Duty: A levy based on the issuance of capital, e.g. the emission of new shares or bonds in the primary market.

Currency Transaction Tax (CTT): A tax that is levied on the gross transaction volume of currency transactions in spot markets as well as in future and derivatives markets involving currency transactions.

High-frequency trading (HFT): An algorithmic trading strategy that profits from incremental price movements with frequent, small trades executed in milliseconds for investment horizons of typically less than one day. See also: Algorithmic trading. (King and Rime (2010))

Financial transaction: In its broadest sense, a financial transaction can be defined as any (contractual) transfer of financial assets or as any payment of money (cash or transfer) between a buyer and a seller attached to the (contractual) transfer of a right with an economic value. In principle the transferred right can be a non-financial good or service as well as financial assets and instruments like equities, bonds, derivative contracts, structured products, repos or currencies. For the purpose of transaction taxes, financial transactions refer in the context of this document to transfers of financial assets and instruments only.

Financial Transaction Tax (FTT): In this document a financial transaction tax is defined as a tax which consists of two elements, namely a CTT and an STT.

Market liquidity: A characteristic of the market where transactions have a limited impact on prices ("price impact") and can be completed quickly ("immediacy"). (King and Rime (2010))

Securities Transaction Tax (STT): A tax that is levied on the gross transaction volume of primary and secondary market transactions with equity securities, debt securities and alike products (e.g. certificates, warrants, units in funds, structured notes etc.) and related (including commodities) derivative products including options, swaps, futures and forwards traded in exchanges and over-the-counter (OTC). STT can also be levied on a subset of these financial instruments.

1.1. Scope of application: Taxable event and place of taxation

This section discusses the basic concepts and prerequisites for an implementation of a financial transaction tax as a general framework to assess the impacts of this policy option. The general concepts outlined below are not related to the precise scope of the tax (CTT, STT

or FTT) but touch upon general implementation requirements. Some of the aspects raised here are also discussed in IMF (2010b).

1.1.1. Primary vs. secondary market financial transactions

The first question that arises when designing a tax on financial transactions is whether this tax should be imposed on both primary and secondary market (financial) transactions or only on one of them. Primary market transactions relate to the issuance of the financial instruments, whereas secondary market transactions refer to the subsequent transfers of those instruments.

One possibility would be to levy the FTT only on secondary markets. The argument for this approach is that a transactions tax is targeting trading activity, but not the process of capital-raising by companies and governments. This is also the basic principle of the Capital Duty Directive (Directive 2008/7/EC). The tax neutrality of restructuring operations is a principle embedded in both the Capital Duty Directive (for indirect taxation/capital duty) and, for direct taxation, the EU Merger Directive (Directive 90/434/EEC). It is derived from the need to remove obstacles to the freedom of establishment and to encourage company cross-border mobility. Also, restructuring operations referred to in the Capital Duty Directive cannot be subject to any form of indirect tax according to the current legislation.

On the other hand, it is obvious and there is theoretical and empirical evidence (see also Annex 12) that the tax burden of a transaction tax will *ceteris paribus* depend on the trading frequency of the issued instrument. If only secondary market transactions are taxed, companies' bonds and equities and governments bonds will depreciate (i.e. the cost of capital will increase) depending on how often they are traded. If the tax was only applied to the primary market, this unequal treatment of instruments would be reduced since every instrument would face the same cost at issuance, but its tax burden would not depend on the trading frequency afterwards.

Some derivatives and especially almost all Over-the-Counter (OTC) derivatives are not traded at all.[1] They are bilateral contracts between two parties with no secondary market as for example also loan agreements. If a tax is levied only on secondary markets, these instruments would remain largely untaxed. If there was the objective to tax transactions in these products a tax on primary markets – to be more precise on the contracting of the derivative – would need to be considered. To the degree that they are not used to raise capital, their taxation would however be possible under the Capital Duty Directive.

Thus, from an economic point of view, in order to avoid further distortions, the alternative to tax both, primary (contracting) as well as secondary market financial transactions might have less disadvantages than taxing only primary or secondary market transactions.

[1] Note that trading in bond markets has indeed decreased since it has been partly substituted by the use derivatives. If a market agent wants to transform interest payments received from a bond or hedge the default risk from a debt security he does not necessarily sell the bonds and purchase assets with the desired interest flow or risk profile but rather keeps the bonds and buys for example interest rate swaps or credit default obligations.

Since the taxation of capital issuance infringes the Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital (Capital Duty Directive) a first legal step necessary for the implementation would therefore be the change of the Directive. Additional changes would need to be introduced with regard to restructuring activities of companies. The Directive states that restructuring operations cannot be subject to any form of indirect tax whatsoever. In order to solve this, an exemption for restructuring transactions could be foreseen.

1.1.2. Taxable event

For all definitions below, the basic concept of the taxable event of a transactions tax is the transfer of ownership of a financial instrument or the registration of a contract in case of OTC derivatives. Hence, the taxable event is defined as the exchange of the instrument and the legal transfer of the property right with all connected rights and duties connected to the ownership. In cases where no exchange of instruments takes place, the taxable event is when the contract is concluded while the chargeable event is at the point where the legal obligations occur. For derivatives the taxable event is accordingly the moment when the contract is agreed upon.

1.1.3. Place of taxation and taxpayer

In order to define the financial transactions that each jurisdiction would be entitled to tax under the FTT, different principles could be used. More particularly, the right to tax could be defined by reference to (a) the tax residence of the parties involved in the financial transaction; (b) the place where the financial transaction is deemed to have taken place; or (c) the place of issuance of the financial instrument being traded. In theory, a tax could potentially employ more than one of the connecting factors at the same time outlined above (thereby extending the potential tax base), as long as double taxation is avoided. A more detailed explanation of each of these principles is provided below.

Within these three principles, the taxpayer could be further distinguished to allow for an application of the tax on certain traders only.

Box (2). Proprietary trading

The tax could potentially be limited to two factors – (i) transactions involving proprietary trading by (ii) financial institutions. Proprietary trading (mainly by investment banks and hedge funds) has been subject to considerable criticism and is assumed to pose significant risks for single institutions, specific markets and consequently for the financial system as a whole. Those concerns are also behind the reasoning for the "Volcker Rule" proposed in the United States that aims to limit the trading that banks do with their own money.

The differentiation between proprietary and non-proprietary trading is however only possible if the regulatory environment is providing the means to clearly identify these transactions and to share the relevant information with tax authorities. The information on proprietary trading would be most accessible at the level of the financial institution, which would normally keep separate track (even separate desks) of proprietary and client trading. The drive of financial regulation towards increased transparency of financial markets could allow that information to be at the disposal of financial markets as well. In that respect, any definitions of proprietary trading for tax and regulatory purposes may need to be broadly aligned.

Proprietary trading in its broad definition can take the form of directional calls (i.e. betting on the market trend), price/risk arbitrage, market-making, hedging, etc. The risk associated and the market impact of those activities may differ significantly.

(a) The FTT based on the Tax Residence Principle

(i) Member States' taxing rights

Under a FTT based on the tax residence of the parties involved in the financial transaction, each jurisdiction would be entitled to impose FTT on every financial transaction conducted by individuals and entities that are considered as residents in this jurisdiction, regardless of where the financial transaction is deemed to have taken place. Under this principle, the market participant would therefore be liable to tax for all his or her global financial transactions in her jurisdiction of residence. The correct determination of the tax residence of market participants must in this case be clearly defined in order to avoid double or non-taxation. This points to the well-known problem of determining the place of tax residence of taxpayers in an international context.

In order to apply this principle it would be necessary to clearly identify the legally relevant buyer and seller of every financial transaction – the persons or companies which actually exchange the property rights and receive the economic benefit from the trade. The tax would be levied on one or both parties involved in the financial transaction, depending on whether they are resident for tax purposes in a jurisdiction applying the tax. If one leg of the trade is a non-resident buyer/ seller, he would accordingly not be taxed. If both parties are resident for tax purposes in jurisdictions levying the FTT, the FTT would be a two-legged tax levied at half the total rate for each leg.

The FTT based on the *Tax Resident Principle* would thus allow the state of tax residence to tax all the financial transactions entered into by its tax residents, regardless of where the trade takes place. By contrast, tax residents from countries without such FTT would not be taxed.

A strict application of this system could mean that investors from countries that do not levy the tax would be tax free and this would create a tax wedge: Non-EU investors might have a higher incentive to invest in a European company/ government bond than domestic residents. In addition, exchange of information with third countries might be necessary[2].

(ii) Tax collection issues

While this principle has advantages, notably that the tax revenue would be distributed according to the financial trading conducted by tax residents, the enforcement and compliance costs must be addressed for mainly three reasons:

a. EU intermediaries

Firstly, the cost of collecting the FTT might be very high. The collection would be possible only if, either every tax resident (private households, companies, government agencies) reports to the tax authorities the financial transactions in which they enter; or, administratively easier and less costly, if financial intermediaries like banks, brokers, funds, exchanges etc. are considered as the collecting agents of the tax.

If the financial intermediary involved in financial transactions effected by residents in jurisdictions where the tax applies is from an EU Member State, it should be in charge of collecting the FTT. There are, however, practical issues with applying that approach. In the first place, intermediaries may not necessarily be in a position to determine correctly the tax residence of their client and to assign the tax revenues to the appropriate Member State. In addition, for some derivatives, as outlined in 5.2.2.2., there may be no consideration (i.e. payment) at the time of contracting, and therefore, no monetary flow from which the tax could be withheld/ collected.

A tax only on proprietary trading of financial institutions would arguably not be as challenging from tax collection point of view, because financial institutions would keep better track of their investments and their economic substance than retail investors.

b. Non-EU intermediaries

If an intermediary in a non-taxing jurisdiction is used, the tax resident is liable to tax. For OTC markets, the tax would be collected when contracts are registered with an official regulatory body (central clearing platforms, trade repositories or other bodies) and only if one of the contracting parties is a domestic tax resident. This would require a high degree of international cooperation on exchange of information with countries where the intermediaries. In addition, the administrative costs for the tax authorities for tracking transactions carried on a global basis may be excessive.

[2] Such systems do already exist. An example is the EU Savings Directive (2003/48/EC).

c. Non-EU financial markets

In order to impose the FTT on transactions conducted by residents in jurisdictions where no tax is applied, the national tax administration may need to receive the information on the details of the transaction taking place abroad not only by non-resident intermediaries, but also by the non-resident financial markets too. This would also require not only a high degree of international cooperation on exchange of information, but also a degree of transparency (and development of that degree of transparency over time) of those non-EU OTC markets that is equivalent to the one in the EU.

d. Relocation

In terms of relocation it should be noted that there is the possibility that a company moves its trading activities to subsidiaries or other related entities in a third non-taxing country and repatriates profits from trading via dividends (which would be exempt either under the non-taxing country's domestic law or under its double taxation agreements), or via transfer pricing arrangements.

Financial transactions carried out on exchanges or where central counterparties are interposed in order to reduce counterparty risk and increase transparency often involve a number of parties and intermediaries. One transaction may be broken down into a series of transactions first between the initiating party and the broker/ dealer who further deals with a member of a clearing house (exchange) and who in turn deals with the central counterparty (CCP)/ clearing house (exchange). The other side of the transaction may be divided in the same number of transactions. In this case for each transaction in the market would need a (cross-border) look-through approach in order to identify the legally relevant agents. A solution to that may be the assignment of withholding/collecting and reporting duties to the intermediary that is immediately acting for the originator of the transaction.

The Anti-Money laundering regulations could be helpful tools to deal with this problem. The advantage of the look-through approach is that buyer and seller could be identified and their nationality or the country of residence for taxation could be disclosed. This would be necessary if revenues are to be shared among the governments involved.

(b) The FTT based on the Source principle

Under a FTT based on the *Source Principle*, each Member State would have the right to tax all the financial transactions that are deemed to have taken place in its jurisdiction, regardless of the tax residence of the parties involved in the transaction. The Swedish transaction tax experience can be seen as a tax levied according to this principle. Alternatively, the place of settlement could be defined as the tax location. Note that the place of settlement and the place of transaction do not necessarily coincide. This might have effects on enforcement and revenue distribution.

Designing the FTT in this way would require defining criteria to determine where a financial transaction is deemed to have taken place. For instance, OTC contracts could be taxed in the jurisdiction where the derivative/ trade is registered or settled, regardless of the tax residence

of the parties to the contract. Financial transactions using exchanges or any organised trade platform can be considered to take place in the jurisdiction where these centralised systems are located.

Carefully defining on whom the tax would fall legally and when the tax can be collected is necessary. For instance, it must be defined whether the FTT is to be paid at the moment of notification of the trade or at the moment of settlement of the contract. Equally, the exchange, settlement system, or central information points which would be legally bound to collect the tax must know which person is liable to pay the tax, the buyer, the seller or both. A possibility would be that these central collecting agents debit the buyer and the seller of each transaction with 50% of the tax.

The advantage of designing the FTT under this principle is that no identification of the party instructing the transaction is necessary. The tax could be collected at central clearing platforms or electronic exchanges and other trading platforms thereby avoiding excessive administrative costs.

Nevertheless, there are some other design issues to be considered, namely:

- It would need to be assured that transactions within a business entity are also taxed, to exclude tax avoidance by vertical as well as horizontal integration (conducting transactions within rather than between businesses): The result could be larger financial institutions creating possibly additional systemic risks.

- The fact that a central tax collection system exists would lead to a geographical concentration of the revenue in countries with major trading centres. Given the strong concentration of financial markets in some Member States the distribution of revenue might be very uneven. Systems of revenue-sharing among countries could also be agreed, but not without related data collection for the sharing.

- The risk that the transactions together with the trading platforms are relocated to jurisdictions which do not levy such a tax is very high.

(c) The FTT based on the Domestic Issuance Principle

Under a FTT based on the *Domestic Issuance Principle*, each Member State would have the right to tax the financial transactions involving securities issued by domestic actors, notably shares and bonds by domestic companies, domestic government bonds and derivative contracts settled or contracted in the country.

This principle is similar to the basic idea of the UK stamp duty where enforcement is strengthened by linking evidence of ownership to the proper payment of the duty. The UK stamp duty taxes only shares of UK-registered firms irrelevant where the trade takes place (see also Annex 8). In the UK the regulations permit a paperless transfer of shares to be registered, provided it is made through an electronic system approved by the Treasury under the regulations. The SDRT regulations impose an obligation on the operator of CREST (or

any other Treasury approved electronic transfer system) to collect SDRT on transfers going through its system The responsibility for paying SDRT rests with the "accountable person" as defined in the SDRT Regulations. This is usually the broker acting for the purchaser of the shares. Where the SDRT is not paid through CREST, the customer is required to send full details of the transaction to the SDRT Office with payment of the SDRT. Once payment is received an official receipt for the payment is issued and any interest on late payment calculated and requested.

1.2. Taxable base

The heterogeneity and rapid evolution of the different financial instruments pose difficulties for the definition of the taxable base of the FTT.

A useful tool to define and track the products covered by the FTT would be a harmonized nomenclature of financial instruments and products in order to guarantee that for tax (and also regulatory) purposes, Member States use equal definitions. A role model could be the Standard International Trade Classification used in the area of customs. All existing financial instruments should be listed in order to make sure that all product definitions are identical in all countries. Without such a tool there is large scope for interpretation with regard to the tax treatment of certain products which could in turn lead to substitution and loopholes.

Nevertheless, it must be borne in mind that employing exhaustive lists would arguably facilitate arbitrage around strict inventory of definitions. Changes to such a list would need to be agreed by Member States.

1.2.1. Spot transactions

The definition of the taxable base for spot transactions should not pose serious problems. There is a large amount of national experience and the value of the asset as priced in the transaction could be taken as the taxable amount. The gross transaction volume would be the tax base.

1.2.2. Derivatives

Defining the FTT base for derivative transactions raises more questions. It has been proposed that the value of the underlying instrument or asset, i.e. the notional value, is used as the taxable base. This value is the nominal or face amount that is used to calculate and record payments on the instrument. This notional value is commonly used in options, futures and currency markets and for a large share of derivatives easier to observe than e.g. prices or premiums which for some products do even not exist.

There is also a more fundamental economic argument for the use of the notional as the tax base. If the FTT were based on the premium, traders are essentially rewarded for using more out-of-the-money options. These products have disproportionately lower premiums due to the higher implicit leverage. For example, if the premium is the tax base traders could switch from an option with the same notional value but a different strike price and reduce the

premium and therefore the tax burden. When using the notional the tax will be invariant to the amount of implicit leverage in the option.

However, the notional value as tax base poses also a number of questions. It is a fictitious reference and may not be taken as the real value of the derivative contract insofar as this underlying asset/instrument is very often not transferred at all. In addition, the link between the value of a derivative and its underlying varies widely among the different types of derivatives, but also within the same type of derivative depending on its terms. Finally, as will be discussed in section 6 using the notional could lead to significant market reactions which have to be taken into account.

Box (3). Derivatives – some background

In financial terms, a *derivative* is a financial instrument - or more simply, a contract whose performance is based on the behaviour of an underlying asset. The price of a derivative is thus derived from one or more underlying assets. It is a financial contract with a value linked to the expected future price movements of the asset it is linked to - such as a share or a currency. Thus, a derivative is an agreement between two parties that is contingent on a future outcome of the underlying.

The underlying could be anything but the most common are commodities, securities, currencies, interest rates, yields, a stock index or other financial measures, transfers of credit risks, climatic variables (i.e. weather), freight rates, emission allowances, inflation rates and economic statistics. The overall derivatives market has five major classes of underlying assets: interest rate derivatives (the largest), foreign exchange derivatives, credit derivatives, equity derivatives and commodity derivatives.

There are many kinds of derivatives, with the most notable being swaps, forwards, futures, and options. Since a derivative can be placed on any sort of security (or indeed behaviour or event), the potential base of derivative contracts is very large. Even derivatives themselves can be used as an underlying asset. Moreover, derivatives can take the form of very complex contracts and are not always based on assets with a direct value to the price of the derivative. For example, weather derivatives are financial instruments that can be used by organisations or individuals as part of a risk management strategy to reduce the risk associated with adverse or unexpected weather conditions. The difference from other derivatives is that the underlying asset (rain/ temperature/ snow) has no direct value to the price of the weather derivative.

Furthermore, compared to bonds and equity, a distinction between primary and secondary market transactions is less relevant, but derivative contracts can also be distinguished by the way they are traded in the market, i.e. over-the-counter (OTC) or exchange (organised markets) traded. OTC or off-exchange trading is to trade financial instruments such as derivatives usually/ traditionally directly between two parties. It is contrasted with exchange trading, which occurs via facilities constructed for the purpose of trading.

Despite these difficulties, to the extent that the notional value would in many cases be the only value which is readily observable in a derivative contract, it would necessarily be the natural starting point for defining the tax base of the FTT, at least for futures, options and forwards, as more fully explained below:

- *Futures/ Forwards:* A **futures** contract is an agreement to buy or sell a financial product or commodity at a reference price (future price or strike price) at a specified

date in the future. Futures are standardized with regard to the quantity and quality and are traded on exchanges. **Forwards** are similar products but contracted over-the-counter (OTC). The tax base for these contracts would be the underlying asset evaluated at the strike price. However, in case these derivative contracts are actually executed, the question arises whether a new taxable event occurs. If that is the case the underlying financial asset would be taxed with FTT (VAT in case of commodities) at that moment at the price stipulated in the contract and double taxation (first taxation is on the derivative contract as such) would occur. As a result any determination of the tax rate applicable to the notional value of derivative should take this into account.

- *Options:* The owner of an **option** has the choice (but not the obligation) to buy or sell a financial product or commodity at a reference price (exercise price) at a specified date in the future; the owner exercises the option if it would be advantageous for him to do so. The underlying evaluated with the reference price (notional value) would be used as the taxable base. For example, one S&P 500 Index futures contract obligates the buyer to 250 units of the S&P 500 Index; if the index is trading at $1,000 (given price), then the single futures contract is similar to investing $250,000 (250 x $1,000). Therefore, $250,000 is the notional value underlying the futures contract. However, in case the option is exercised the question arises whether a new taxable event occurs. If that is the case, the FTT tax base relating to the transaction of acquiring the underlying financial asset would be the exercise price (normally VAT taxation in case of commodities) and it would be logical to only apply FTT to the premium paid in respect of the option contract as such.

- *Swaps:* Defining the notional value for **swaps** might be more difficult, since easy transformations can decrease their value. For example, interest rate swaps are agreements to exchange, over a period in the future, a series of fixed interest rate payments for a series of variable interest rate payments. The notional value of an interest rate swap could be divided by an arbitrarily large number while the interest payments are multiplied with the same number. The contract would be economically the same but the tax base defined as the notional would be close to zero. In this case a substance over form or some other legislative limits have to be introduced in order to avoid these effects. In the case of a credit default swap (CDS) - which is a swap contract in which the purchaser of protection (the CDS) makes a series of payments to the protection seller and, in exchange, receives a payoff if a credit instrument (typically a bond or loan) defaults the base could be the insured underlying.

The examples above illustrate that the notional value can be used as the taxable base of the FTT in certain financial transactions. However, the notional value is difficult to determine in some other transactions (for instance the weather derivatives mentioned in box (5) credit default swaps or structured products if derivatives are involved). In these cases, other proxies for the tax bases have to be found. In these cases premiums paid for the contract or on the value to be paid in case of the occurrence of the “insured” event could be used.

In any case, the multitude of financial products would need to be filed and catalogued in order to have an internationally agreed tax base for each product category. If the notional is not applicable alternative other values could be considered which can serve as a taxable base.

Box (4). Issues specific to structured products

Structured products are similar to derivatives in the sense that they are market-linked products. There are multitudes of product categories within the category of structured products, allowing different "packaged" investment strategies. For example, a structured security may take the form of a note that provides varying degrees of capital protection (e.g. from 30% to 100%, but also above). Such types of products have become increasingly popular with retail investors. The investment is essentially split into two parts. One part (e.g. 90 of an investment of 100) is invested in a zero-coupon bond that would yield 100 upon maturity of the structured note, while the remaining 10 are used to purchase derivatives (e.g. options and/or swaps) to track a reference security/basket/market. The leverage of those derivatives allows significant (contingent) returns on the note, combined with capital protection.

A simple approach in taxing structured products of the type outlined above would be to tax the investment of 100. Nevertheless, such an approach would omit the nature of the embedded derivatives and the potential leveraged profits associated. It would also pose an issue of lack of consistent treatment of self-standing and embedded derivatives.

Normally, accounting rules would have to "pierce the veil" of the structuring by applying a "bifurcation" approach, reporting the embedded derivatives separately. Such an approach may be applicable for corporate investors that apply accounting rules, but does not appear practical with regard to individual retail investors.

The above example is provided for illustration purposes only. In other cases the embedded derivatives may not be that easily identifiable or measurable.

1.3. Exemptions

Financial intermediaries: clearing members, clearing house, brokers could be exempted for reasons of tax neutrality and to preserve liquidity in the market. This would however reduce taxable volumes significantly.

In addition, hedging activities through derivatives may be seen as disadvantaged from the levying of a FTT based on the underlying. Although there may be arguments that a very low tax rate would not have a significant impact, the actual tax paid may be substantial compared to the 'price' paid for the hedging (e.g. the premium in case of options). Therefore, an exemption may need to be implemented, e.g. through a refund for hedging activities. The use of hedge accounting by the contracting party with regard to the specific derivative may be an indication which could potentially be used for the exemption if the FTT is based on the Tax Residence Principle.

A tax levied only on proprietary trading would effectively exempt all non-financial institutions and private investors.

1.4. Types of FTT

The tax principles and tax bases outlined above can be applied to different product scopes. In the recent discussions three transactions taxes have been in the focus and will be the variants of this policy option discussed in this Impact Assessment.

1.4.1. Option 1A: Currency Transaction Tax (CTT)

A tax on currency transactions is based on the initial idea for a transaction tax on foreign exchange markets by Tobin (1974, 1978). He argued that the increased mobility of private financial capital - especially after the end of the Bretton Woods system - might lead to excessive shifts of funds that create real economic costs for national governments and economies. Tobin reasoned that the tax could increase the effectiveness of domestic monetary policy. This document uses the name CTT and not the expression 'Tobin Tax' which is sometimes used in the popular debate.[3]

The basic idea of the CTT is to levy a tax on currency transactions and related instruments (FX forwards and FX swaps) transactions. The collection would take place centrally at currency exchange systems, namely in Real Time Gross Settlement (RTGS). A real-time gross settlement system (RTGS) is a payment system in which processing and settlement take place continuously ('in real time') rather than in batch processing mode. Like this, transactions can be settled with immediate finality. 'Gross settlement' means that each transfer is settled individually rather than on a net basis. In the EU such a system is Target2 (Trans-European Automated Real-time Gross Settlement Express Transfer System), which is operated by the Eurosystem and comprising 26 Member States. For transactions which are tracked in such systems a tax could be levied centrally.

Proposals for such systems have been made by the Report of the Committee of Experts to the Taskforce on International Financial Transactions and Development for the Leading Group of countries (2010), Jetin and Denys (2005) and Spahn (2002). A recent study on revenue estimates based has been published by Schmidt (2008). Compared with other transaction taxes the technical discussions are more advanced for the CTT. In this respect, it should be noted that many proponents and notably the report of the Leading group of countries explicitly favour a global application of the CTT.

Also, note that this option raises legal concerns which would need to be addressed by adapting core elements of the TFEU. See Box (5).

[3] Tobin himself argued a few months before his death that his name was misused in the debate on financial transaction taxes. See http://www.econ.yale.edu/news/tobin/jt_01-09-02_ds_misusing-name.htm for an interview with Tobin on this.

Box (5). Legal issues with a CTT

A Currency Transaction Tax, i.e. a levy the taxable event for which is the exchange of currencies, indirectly restricts the underlying transactions, both between Member States of different currencies and between Member States and third countries, by rendering them more costly. This may affect payments for the supply of goods or services (current payments) and investments made, for example, by pension funds (capital movements). Although the levy would not apply to the cross-border flow of money as such, it would, absent similar effects on purely national flows, restrict free movement of capital, within the meaning of Article 63 TFEU. This provision commits not only Member States, but also the Union.

Nothing can justify this restriction, since the cross-border flows affected are not objectively different from purely national flows (or flows within a single currency zone [i.e. the euro area]), nor could any overriding reason relating to the public interest serve as a justification. Even if e.g. raising funds to benefit stability funding were to be considered as an overriding requirement of general interest, that requirement could not explain why transactions involving countries with different currencies would be treated less favourably than those involving only one currency. Furthermore, the tax is considered to be disproportionate as funds could alternatively be raised by other means of budget attribution without affecting a basic freedom of the Treaty and, in any event, because the scope of the tax would be unrelated to the risks to be covered by the tax revenue raised. Even a very low tax rate would constitute an infringement, and it would not be possible to establish a threshold of insignificance.[4]

As regards Council Directive 2008/7/EC, its Article 5 (2) provides that Member States shall not be subject to any form of indirect tax the creation, issue, admission to quotation on a stock exchange, trading with stocks, shares or other securities of the same type, or of the certificates representing such securities. This concerns also loans, including government bonds, raised through the issuance of debentures or other negotiable securities, or any formalities relating thereto. Article 6 (1)(a) of the Directive 2008/7/EC expressly states that "[n]otwithstanding Article 5, Member States may charge duties on the transfer of securities, whether charged at a flat rate or not."

It would need to be assessed whether these rules of Directive 2008/7/EC would oppose the introduction of currency transaction levy, in which case its introduction would require a corresponding change of the Directive.

1.4.2. Option 1B: STT without derivatives and currency transactions

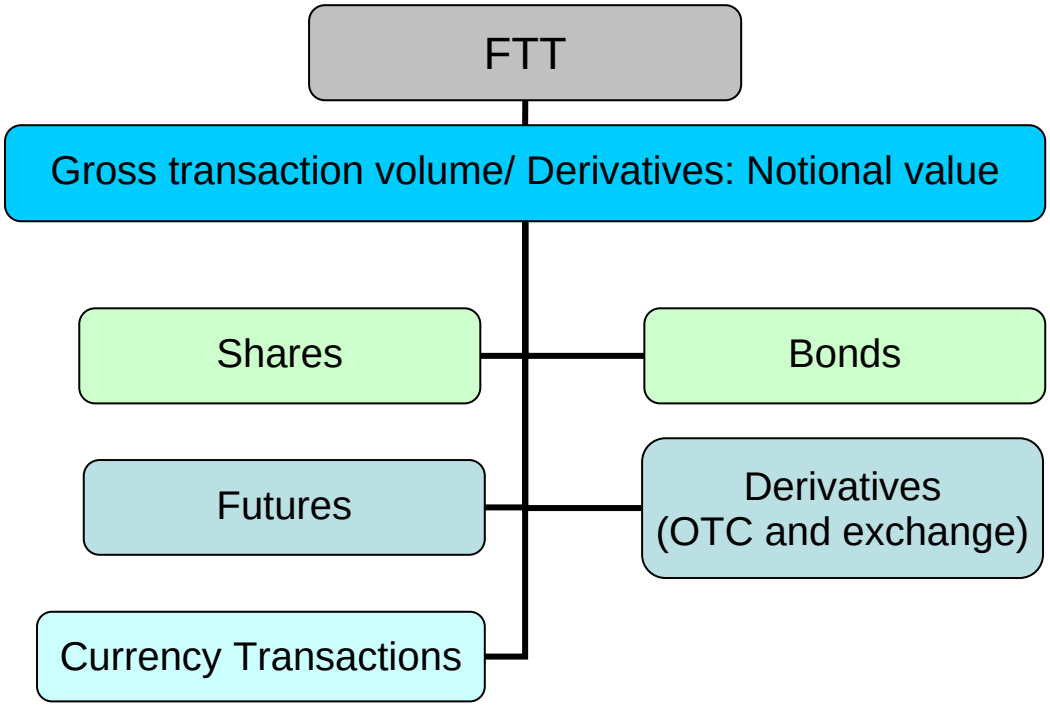
The STT without derivative and currency transactions corresponds to the narrow-based transaction tax described in the SWD on financial sector taxation which would tax only the spot transactions of equities and bonds. It would be levied on all bonds and stock transactions executed in regulated markets thereby making the technical implementation cheap and easy since these systems are operated with centralized economic systems. This option is similar to the UK stamp duty when combined with the domestic issuance principle. Note that for the bond trading product substitution must be considered. It is easy to replace fixed-interest securities with standard bank loans or deposits which are exempt according to the current proposals.

[4] On free movement of capital and CTL, cf. also Opinion of the ECB on the 4 November 2004 at the request of the Belgian Ministry of Finance on a draft law introducing a tax on exchange operations involving foreign exchange, banknotes and currency (CON/2004/34). http://www.ecb.int/ecb/legal/pdf/en_con_2004_34_f_sign.pd

1.4.3. Option 1C: FTT

This option would cover all financial transactions as outlined above. In fact, it consists of the STT and the CTT. Since it would cover also OTC markets a full coverage of transactions and access to all transactions data is necessary to effectively be in a position to levy the tax independently of the tax principle chosen. Figure (1) shows the products covered in Option 1C.

Figure (1): Variants of an FTT



1.5. The tax rate

Generally, the level of the rate would depend on factors such as the revenue potential, the level of impact on targeted markets or the importance of the tax rate relative to the transaction costs in specific markets. There is obviously a link between the tax base and the tax rate of the FTT. Thus, if, as illustrated above, the notional value of a derivative contract is taken as the tax base but this value does not reflect the real value of the product at stake, in order to avoid

excessive taxation of such a product, a “lower” tax rate (or a range of “lower” tax rates) is advisable.

With regard to the structure of the tax rate, two options are possible: a flat rate and differentiated rates.

1.5.1. Flat rate

One option is to set a uniform rate for all transactions. This has the merit of being simple and easy to comply with, but it might not sufficiently take into account the specifics of the products traded and the potential impacts on the different markets.

Most recent proposals assume a low statutory tax rate which ranges between 0.01% and 0.1%. An exception is the above mentioned proposal for a CTT by the Committee of Experts to the Taskforce on International Financial Transactions and Development for the Leading Group of countries (2010). They explicitly want to avoid market distortions and suggest a tax rate as low as 0.005%.

By contrast, some Member States have experience in applying stamp duties on equities amounting to 0.5%, and even 1.5% to address tax avoidance. Note that these duties do in general not include derivatives in its scope. However, a tax rate of 0.5% might have much stronger effects if it is applied to notional values in derivatives markets than in equity markets. Thus, a relatively low level of taxation is likely to be essential to avoid strong negative impacts on markets and to ensure some revenue collections, since the incentives for avoidance increase with the tax rate. (See also Annex 10 for a detailed description of the effective tax rates and other economic issues.)

1.5.2. Differentiated rate

A second option is to set differentiated rates, depending on several factors.

- Varying tax rates could be based on the impact of different tax burdens of financial instruments on markets and the (political or economic) desirability of the instrument.

- Tax rates could also be differentiated according to the type of counterparty: banks, other financial institutions (such as hedge funds) for their proprietary trading and non-financial corporations, for example if one makes the assumption that certain of these categories are more prone to speculative trading than others or if reductions in trade volume are different. This information would have to be gathered for all traders in financial markets.

- Another approach might be to look at existing transaction costs and spreads in the various financial market segments. Indeed, these transaction costs will determine the impacts on market liquidity and a transaction tax would clearly be a (new) part of these costs. In markets with high transaction costs (less liquid assets) a single rate is likely to impose a much smaller percentage increase in the transaction costs than where these are low (more liquid assets). In the first case the transaction tax will

have less impact on liquidity. Hence, tax rates might be defined relative to existing transaction costs to avoid large impacts on markets. This would of course imply the exercise of defining the current level of transaction costs for different markets (products) or market segments, both exchange (organised markets) and OTC. An update mechanism relying on unanimity would need to be set.

- Pollin et al. (2002) proposed the following scale of tax rates for a possible Security Transaction Tax (STT) for the US based on the principles of taxing the value of the asset being traded which does not necessarily equal the notional value, and of taking into account the existing transactions costs by adapting the tax rate to the transaction costs level. The proposal takes the 0.5% rate of the UK stamp duty on equities as the benchmark for establishing rates in other markets in a way that minimises distortions:

  – Bonds: 0.01% per each year until bond's maturity.

  – Futures: 0.02% of the notional value of the underlying asset.

  – Options: 0.5% of the premium paid for the option.

  – Interest Rate Swaps: 0.02% per each year until maturity of the swap agreement.[5]

  – Foreign exchange: 0.01% on each spot transaction.

Box (6). Technical aspects dealing with relocation

Although not directly linked to the technical feasibility of a transaction tax, it will be of vital importance for the potential success of any FTT to avoid (or to assess the risk of) relocation of transactions to havens where the tax does not apply - if the tax is not introduced in all countries where major (or to become major) financial centres are located.

First, if Member States decide to tax according to the Residence Principle or the Domestic Issuance Principle, relocation for tax purposes might be pointless in the theoretical case of full and cheap enforcement. In reality, these taxation principles will however raise problems of implementation and of enforceability in the absence of well functioning administrative cooperation and strict reporting obligations to national authorities by domestic intermediaries (source principle) as well as domestic and foreign intermediaries/ tax administrations (residence principle). In case of a unilateral introduction of the tax at EU-level information sharing mechanisms with third countries should be implemented if the residence principle is envisaged.

Second, there are already differences in transaction costs and spreads between countries and the impacts of these and the increase of existing transactions costs due to the introduction of a transaction tax seem to be a determinative factor to assess possible relocations. How far can transaction costs be stretched before relocation occurs? Successful (derivatives) markets enjoy a combination of characteristics and low transactions costs are only one of them. Other factors include ready access to capital, a solid regulatory regime, legal certainty and

[5] Baker, Pollin, Mc Arthur and Sherman (2009) took 0.01 percent for each year until maturity for the sake of revenue calculations following the pattern with bonds.

political stability, and a large pool of professional talent.

Third, some market places might have a unique position or benefit from "network externalities" which would outweigh the burden of the tax so that it is still an attractive venue for trade. Some researchers refer to the extreme concentration of transactions on exchanges in Europe (only 6% are spot transactions, 94% refer to futures and options) to show that network externalities are well established. However, it can be expected that rivalry amongst the world's leading financial centres is very intense and market concentration might change quickly. This is particularly important for an application of the tax with limited geographical coverage. If it is considered to tax at EU-level only, it seems indicated to include at least the major financial centres in Europe, i.e. London, Zürich, Frankfurt, Geneva, thus including Switzerland.

1.6. Double taxation issues

As outlined above, States could decide to tax according to the (a) Residence Principle (b) Source and Territoriality Principle (c) Domestic Issuance Principle. In an extreme case all or a mix of these principles may be applied at the same time by the taxing States. In this case the potential for double taxation is obvious if the tax is applied in more than one state. More specifically, if for example a Member State A applies the source principle while another Member State B the domestic issuance principle, double taxation might occur when securities with origin in Member State B are traded in A. On the other hand, if A applied the domestic issuance Principle whereas Member State B would apply the tax resident principle, non-taxation of Member State's B equity traded by tax residents of Member State A would occur. Therefore it is again necessary that governments which consider the introduction of such taxes co-ordinate in order to avoid double or non-taxation.

The different principles needed to establish the taxation competence of States could be combined in a way that double or non-taxation is minimized to the largest extent possible and that revenue is more equally spread between countries.

2. POLICY OPTION 2: FINANCIAL ACTIVITIES TAX (FAT)

2.1. Rationale

The FAT can best be defined as a "group of taxes"; these taxes share a certain common root but may nevertheless differ considerably. In essence, the FAT would be levied on the sum of profit and remuneration of financial institutions, since one common rationale behind all the forms of FAT is the fact that would a rent occur, it will go either to shareholder in terms of higher profit (dividends or capital gains) or to workers (via higher remuneration). However, as more fully explained below, a FAT can take several possible forms depending on how profit and remunerations are defined and which objectives are pursued with the introduction of the tax.

2.2. The FAT as a direct or indirect tax

Whether the FAT is interpreted as direct or indirect tax has important effects with regard to its potential legal base as well as its integration with other taxes. Broadly speaking, a FAT would

be imposed on value added. This is, similarly to a tax on value added; the FAT would aim at taxing the difference between (i) the proceeds of providing financial services and (ii) purchases of non-labour inputs of financial institutions. This would be equal to the sum of profits and labour costs of said financial institutions. However, the fact that the FAT and the value added tax share the same underlying economic principle and that it is argued that the FAT could serve to address the current VAT exemption of the financial sector, does not necessarily mean that the FAT is an indirect tax.

The classification of the FAT as a direct or indirect tax does not merely belong to an academic debate. As more fully explained below, the definition of the scope of the tax, the methods to avoid double taxation, the interaction between the FAT and other taxes, and even the choice of the legal basis of the TFEU which would eventually allow for a harmonised introduction of the FAT in the EU, depend on whether the FAT is considered a direct or indirect tax. In this respect, there is not a unique definition of what a direct or indirect tax should be, but, rather several criteria which are often used to classify a certain tax as a direct or indirect, as follows:

- whether the taxpayer is or is not the person on whom the economic burden of the tax is expected to fall;

- whether the assessment of the tax takes into account the circumstances of individual taxpayers;

- whether it is a 'personal' tax or 'in rem' tax;

- whether the tax is levied at regular intervals on sources of income such as employment or property (direct taxes), or on producers in respect of the production, sale, etc. of goods and services, which they charge to the expenses of production (indirect taxes);

- whether the tax is a tax on income (including capital gains and net worth) (direct) or on consumption (indirect).

Under any of these criteria above, the FAT seems closer to a direct tax than to an indirect tax, since (i) there would not be a legal obligation to pass the FAT on to the consumer of financial services on a transaction-per-transaction basis; (ii) the assessment of the FAT would take into account the circumstances of the financial sector; and (iii) the FAT would be periodically levied on all entities that can be classified as financial institutions, on the amount of profits and remuneration that they obtain and pay, respectively, over the relevant period.

Accordingly, even if the FAT could be considered as a 'hybrid' tax, sharing features of both direct and indirect taxes (particularly the addition method FAT), for the purposes outlined above, it will be considered as a direct tax.

2.3. Scope of application – the geographical dimension of the FAT

Proposals have been made to design the FAT, particularly the addition method FAT or FAT1, in a way that would essentially mirror the origin/destination principles ruling value added taxation.

Box (7). Design of a tax on the basis of the origin/destination principles ruling value added taxation

1. An origin-based tax

A first option is to design an origin-based tax. This tax would be levied on the profit from domestic production. The base would therefore be the proceeds from domestic and foreign sales minus the cash disbursements on purchasing domestic and imported inputs (including capital goods). An origin-based tax would normally allow for the deduction of labour costs, however, insofar as the FAT would also be imposed on (excessive) remuneration for labour, (at least part of) the labour costs would not be deductible.

2. A full destination-based tax

A second option is to design a full destination-based tax. This tax would be levied only on the profit from domestic sales (i.e. on the profit of sales to domestic consumers both by domestic or foreign companies). The tax base would therefore be the proceeds from domestic sales minus the costs on the inputs (material and capital) used for the production of the goods and services sold domestically. A method of apportionment would determine the overhead costs to be considered in each country. A destination-based tax would normally allow for the deduction of the labour costs that are attributable to the domestic sales, however, insofar as the FAT would also be imposed on (excessive) remuneration for labour, (at least part of) the labour costs would not be deductible.

3. A VAT-type tax

A third option is to design a VAT-type tax. This tax would be levied on the profit from domestic sales (i.e. considering the proceeds of sales to domestic consumers both by domestic or foreign companies). The tax base would be the proceeds from domestic sales minus the costs of domestic purchases. Similar to VAT, export sales would not be taxed but all imports would be. A destination-based tax would normally allow for the deduction of labour costs, however, insofar as the FAT would also be imposed on (excessive) remuneration for labour, (at least part of) the labour costs would not be deductible.

A destination-based FAT

It is argued that a FAT matching the destination basis of value added taxes would best address the VAT exemption of financial services. Under a destination-based FAT, neither borrowing from nor lending to non-residents would be taken into account for the purposes of assessing the FAT payable by a given financial institution.

However, implementing an FAT in such a manner would require that financial institutions keep separate accounting track of domestic and foreign financial transactions. Furthermore, it

would require defining criteria to distinguish domestic and "foreign" financial transactions (by reference to the borrower, the place of establishment, etc). To the extent that the foreign transactions would not be taxed under the destination-based FAT, the risk arises that financial institutions attempt to maximise their "foreign" transactions in order to avoid paying FAT (relocation risks). Finally, it would very likely oblige financial institutions to register for FAT purposes.

An origin-based FAT

Under an origin-based FAT, borrowing from and lending to non-residents would also be taken into account. This origin-based FAT is also sometimes referred to as the source-based FAT. Indeed, to the extent that the FAT can be better classified as a direct tax, which is levied on the institution and not on the transaction, it should be possible to use the concepts of source and residence to define the scope of application of a sort of origin-based FAT.[6]

A residence/ source-based FAT

Designing the scope of application of the FAT on the basis of residence and source principles would have as an advantage that all EU Member States have wide experience on applying these principles in an international setting. The FAT would only be an additional direct tax. At the same time, international direct taxation is far from being a fully harmonised area of taxation, or absent of conflicts. The FAT could be designed to minimise some of these conflicts but, to the extent it is built up on the principles of international taxation principles, it would also certainly share some of them.

A FAT designed in accordance with the residence principle would be levied on the worldwide profits of the financial institutions that are resident for tax purposes in one of the EU Member States. This would mean that the income and expenses of financial transactions with non-residents would also be considered for FAT purposes. A method to avoid double taxation must be envisaged so that the dividends of EU subsidiaries are not subject to FAT in more than one EU Member State (see below).

In order to better proxy an origin-based FAT, the residence-based FAT on EU domestic institutions should be coupled with a source-based taxation of EU branches (i.e. permanent establishments) of non-EU financial institutions. These would be subject to FAT in the EU Member State where they are located.

An origin-based FAT would probably also require that non-EU financial institutions, whose activity in the EU is not intense enough to give rise to a permanent establishment, pay FAT on their financial transactions with EU residents. The best way of applying the FAT in these cases would be a withholding tax. However, withholding FAT on a transaction-per-transaction basis for non-EU residents could conflict with the Double Tax Conventions (DTC)

[6] It is difficult to identify the residence/source principles of direct taxation with the destination/origin principles; the OECD draws a parallelism between the residence principle and the destination principle; and the source principle and the origin principle, even if it is acknowledged that residence and consumption are not equivalent and that source is associated with income, while origin is associated with production. See OECD (2007) Box 7.1.

following the OECD Model Convention. If the return to the financial transaction made by the non-resident financial institution in the EU is classified as a dividend or an interest, the withholding tax might be allowed under the DTC. By contrast, a withholding tax would likely contravene most DTC if the income earned by the non-EU resident is classified as business income (or even if it is classified as a capital gain, depending on the specific DTC).[7]

2.4. Taxpayer

The FAT would be levied on corporate taxpayers that can be classified as financial institutions. The FAT should be levied on a range of financial institutions as wide as possible in order to avoid that the financing activity shifts to the quasi-financial sector. The financial sector would certainly include banks, credit card companies, insurance companies, consumer finance companies, management fund companies, stock brokerages, investment funds, hedge funds and some government sponsored enterprises, regardless of whether these entities are or not subject to Corporate Income Tax in their respective Member State of residence.

It has been proposed that all the enterprises conducting more than a certain threshold of financial activities become subject to the FAT. Such a threshold could be defined, for instance, in relative turnover terms (turnover of financial activities as compared to the total turnover of the enterprise, or using the VAT pro-rata of the enterprise as benchmark).[8] Such an approach would allow taxing also intra-group financing and shadow-banking activities.

Referring to the weight of the financial activity as compared to the total business activity could be the only criterion to define the FAT taxpayer or could be used in combination with a list of entities that would in any case be subject to the FAT – those mentioned above.

2.5. Taxable base: the different FAT and methods for calculation of relevant profits

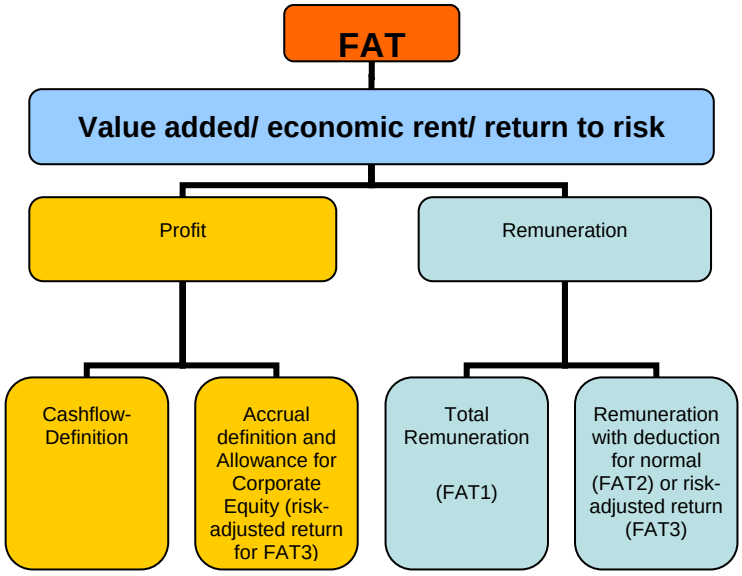
As mentioned, the FAT would be levied on the sum of profit and remuneration for labour of financial institutions. Technically, there are different ways of defining profit and remuneration for FAT purposes. The choice of the method depends on the ultimate objective sought with the introduction of the FAT, namely, taxing value added, taxing economic rents, improving market efficiency and/or discouraging risk-taking activities.

The figure below illustrates how different methods to calculate the taxable base for FAT purposes can be conceived to achieve different FAT, which would in turn pursue different economic objectives.

Figure (2): Variants for a FAT

[7] Intermediation fees earned by financial institutions can be considered as business income which means that they would normally be exempt from any withholding tax at source pursuant to DTCs. Furthermore, in order to ease the raising of capital by their domestic borrowers, EU Member States have progressively eliminated the withholding taxes on interest, or certain types of interest.

[8] The classification of the taxpayers depending on their turnover is for instance very often used to identify SMEs (also for direct taxation purposes).



2.5.1. Option 2A: The addition method FAT (FAT1)

The addition-method FAT intends to tax value added of financial institutions. Given the difficulties to determine the value added of financial activities on a transaction-per-transaction basis, the FAT would tax the aggregated value added of all the financial activities undertaken by a given financial institution during a certain period of time.

In order to better achieve this, the profit and remuneration of the financial institutions for FAT1 purposes could be calculated on a cash-flow basis. This cash-flow tax would be effectively levied on economic rents – this is, from an economic point of view, on projects with a positive net present value.

Box (8). Cash-flow taxes

Cash-flow taxes have been the subject of a relatively rich amount of economic literature, starting with the recommendations of the Meade Committee (1978) in the UK (which work is currently being followed-up by the Mirrlees Review).[9] In its simplest definition, a cash-flow tax at the corporate level would tax corporations on the difference between the sales of goods and services and the purchases of goods and services from other businesses and from employees. This makes two major differences compared to a classical corporate income tax: (i) assets are immediately expensed rather than capitalized and depreciated – or re-evaluation and appreciation of the assets would not be possible either; (ii) sales and purchases are accounted for on a cash-basis and not on an accrual basis (Bradford, 1986).

Cash-flow taxes are typically assessed on the profit resulting from real – in the sense of non-financial – transactions (R). However, the nature of the activities of the financial sector makes it impossible to distinguish the "real" from the financial transactions (F).

A cash-flow FAT would be applied on the so-called R+F base.[10] This would be formed by (i) the sum of cash-in from sales, borrowed funds, interest received and loan repayments, minus (ii) the sum of cash-out from purchases and investments, interest paid, debt repaid and lent funds. Cash in and out from trading with derivatives or any other financial instruments would also be considered. In principle, remuneration for labour is not included as a tax-deductible expense and would consequently be taxed.

Arguably, cash-accounting would lead to lesser differences across EU Member States than accrual accounting. From a practical point of view, there would be two methods to calculate the FAT taxable base in cash-flow terms, considering the available data for accrual accounting:

- Under an indirect method, the FAT taxable base in cash-flow terms could be calculated by adjusting the Profit and Loss Account (P&L) result calculated in accrual accounting (i.e. the profit as used for the calculation of CIT). In essence, such calculation would require deducting from the P&L result the full cost of the investment undertaken by the taxpayer during the year and adding back the depreciation and the remuneration for labour. Remuneration would be broadly defined, it would include wages and salaries, bonuses and other performance-related pay schemes, as well as non-financial advantages (e.g. company cars, company phones, etc). Please refer to section 6.2.2 and to Annex 11 on revenue estimations to find an approximation of the indirect method, which has been used for calculating the revenue potential of the addition method FAT.

- Under a direct method, the profit in cash-flow terms would be calculated as the difference between (i) cash-in from sales and trading of financial products, services and fixed assets plus the increase in borrowing plus interest income minus (ii) cash-out from the purchase and trading of financial products, operating expenses, and investment in fixed assets, plus the repayments of borrowing and interest paid. Wages would not be considered as deductible.

2.5.2. Option 2B: The rent-taxing FAT (FAT2)

The FAT can also be designed to tax economic rents only. Such a tax would be designed by taxing profit and remuneration for labour above a defined level. The rent-taxing FAT aims at taxing the rents accruing to the financial sector while leaving untaxed the normal return to capital and labour factors. The taxable base of FAT2 could be calculated in the following ways:

- For the profit part, the normal return to capital can be exempted by using the result of the P&L, adjusted with an Allowance for Corporate Equity (ACE). The Allowance for Corporate Equity or ACE would allow a deduction for a notional return to equity, which would be calculated by reference to the interest rate payable on low-risk debt (government bonds, for instance). Some countries use this method in order to allow a tax deduction that is designed to be roughly similar to the cost of debt-financing. A possibility would be to couple this ACE with a restriction of the deductibility of the

interest expense on debt to the same rate, so that an identical normal return on debt and equity is untaxed. Another method could be one general allowance rate for total corporate capital (see Annex 18 for more details).

- For the wage part, the normal return to labour can be exempted by providing an allowance for 'normal' remuneration. Such 'normal' remuneration per employee could be for instance defined as the average remuneration in other non-financial sectors, possibly correcting for the type of functions[11].

2.5.3. Option 2C: The risk-taxing FAT (FAT3)

A third version of the FAT would tax excess return due to unduly risky activities. This version of the FAT is very similar to the rent-taxing FAT because would leave untaxed the 2normal profit" and the "normal remuneration for labour". However, the risk-taxing FAT would determine the 'normal profit' by adjusting the P&L result with a higher ACE (i.e. higher 'normal' return for corporate equity), so that only the excessive return to (average) equity is taxed.

The reason is that this excessive return is arguably the result of high risk-taking activities. Therefore, parts of the rents could theoretically be untaxed as long as the return to equity does not exceed this threshold. Similarly to the FAT2, only expenses for remuneration for labour over a certain threshold would also be added-back to the P&L result and be, consequently, taxed.

2.6. The tax rate

The Commission SWD has used a 5% rate for illustrating the revenue collection potential of the FAT. However, the appropriate FAT rate would depend on the revenue collection expected and on the other objectives pursued by the introduction of the FAT (mostly on the FAT taxable base).

An argument could be made in favour of an FAT rate equal to the VAT rate, so that the FAT best addresses the VAT exemption of financial services. However, to the extent that financial institutions may not recover input VAT, such a rate could excessively burden the sector.[12] Nevertheless, linking the FAT rate to the VAT rate applicable in the Member State would be an option worth considering in the final design of the FAT but this could be hampered by inconsistencies in the actual impact of non-recoverable VAT (see in particular Annex 17 for a discussion on these issues).

Economic literature proposing the cash-flow taxation as a substitute for the classical Corporate Income Taxation notes that the neutrality of the tax with respect to investment depends crucially on the tax rate being constant over time.[13] In addition, a unique, or at least very similar, FAT rate applicable across the EU would probably be desirable in order to minimise distortions and to ease the application of the methods to avoid double taxation (both issues are further addressed below).

In summary, tax neutrality would call for an FAT rate lower than the VAT rate, which would be as harmonised and constant as possible for all EU Member States. The revenue estimations

provided under section 6.2.2 are calculated using a 5% tax rate for FAT which corresponds to the minimum reduced VAT rate in the EU.

2.7. Double taxation issues

The introduction of an FAT, in whatever of the forms described above, would cause different double taxation issues, which must be distinguished. First, there is the treatment of losses under FAT and the risk that the profits of a certain financial institution operating in several EU Member States be taxed twice or multiple times under the FAT of different Member States. Secondly, there is the interaction between FAT and other existing taxes, notably the VAT, which are generally referred to as cascading effects, but also with CIT (even in non-EU Member States). They are addressed below separately.

2.7.1. Treatment of losses under FAT

Each type of FAT calls for a different treatment of the losses, since each of them would pursue a different goal:

- Addition method FAT or FAT1: symmetrical treatment of gains and losses, this is, carry-forward of losses should be allowed.

- Rent-taxing FAT or FAT2: the carry-forward of losses should be allowed so that the tax falls on pure economic rents.

- Risk-taking FAT or FAT3: Allowing the carry forward of losses would not help discouraging highly-risky activities, because the losses in one year would be used to compensate excessive risk-taking in other years. Carry-forward of losses should therefore not be permitted under the FAT3.

2.7.2. FAT Double taxation - relief for losses and for FAT in other countries

To the extent that the FAT is introduced in all EU Member States in a coordinated fashion, FAT double taxation should not be too complex to avoid at least in a purely EU context. Indeed, the more coordinated the FAT across EU Member States, the less complex would be to design an effective method to avoid double taxation.

If the FAT is levied on an entity-per-entity level on a stand-alone basis, a method of imputation or exemption of dividends could be envisaged to relief double taxation in a profit-making context. This, however, would leave unsolved the taxation in loss-making situations (provided that a FAT allowing the compensation of losses is adopted). Technical rules on the treatment of losses made by group entities in different Member States would probably be needed so that the FAT is as neutral as possible within the EU.

Another possibility would be to have the FAT applied on a consolidated base at EU level. The current proposal on a Common Consolidated Corporate Tax Base (CCCTB) could serve as a model to arrive to an EU-harmonised FAT tax base.

2.7.3. FAT-VAT interaction: cascading effects

The interaction (or rather, the lack of it) between the FAT and the VAT would be similar to the interaction between VAT and any other direct tax. This is, to the extent that the FAT would not be assessed on a transaction-per-transaction basis, it would not be possible to have the FAT properly invoiced on transactions between financial institutions and business subject to VAT. The financial institutions subject to FAT would not be able to credit input VAT against their payable FAT (the problem of non-recoverable VAT is further analysed in Annex 17). In addition, business subject to VAT would not have the possibility to credit the FAT for VAT purposes or to obtain credit for the unrecoverable VAT borne by the financial institutions from which they have received financial services.

Some technical measures have been suggested to try to alleviate the cumulative effect of having two different taxes, VAT and FAT, on the same concept (value added). It is has been proposed to allocate credits for FAT to business on the basis of an approximation, or to have an FAT rate lower than the VAT rate. None of these solutions seems entirely satisfactory but further technical work may be carried out to minimise this distortion. As more fully explained in Annex 17, the potential integration of FAT and VAT would also very much depend on whether the VAT exemption of the financial services is kept in the current terms or whether a form of taxing them for VAT purposes is introduced.

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IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

{COM(2011) 594 final}
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ANNEX 8

COUNTRY EXPERIENCES

1. TRANSFER TAX AND STAMP DUTIES

Belgium

In Belgium, there is securities tax (referred to as “tax on stock exchange transactions” or “stamp duties”) which applies to certain transactions concluded or executed in Belgium through a Belgian professional intermediary, to the extent that they relate to public funds, irrespective of their (Belgian or foreign) origin. The tax is not due upon subscription of new securities (primary market transactions)

The transactions in scope are:

- every sale, purchase and, in general, every transaction for valuable consideration (secondary market transactions) On a given secondary market transaction, the tax is due twice: in the hands of the seller (sale) and in the hands of the buyer (purchase) provided that the transaction is carried out between Belgian parties;
- every redemption of its own shares by an investment company provided that the redemption relates to "accumulating shares".

All types of financial instruments are covered, for instance equity, shares of investment companies, bonds, and some derivative instruments. However, the transaction must relate to public funds. The notion "public funds" refers to all marketable securities, which, by their nature, are susceptible of being traded on an organized exchange.

The tax is not due if no Belgian intermediary acting in the course of its business intervenes in the transaction (being the acquisition or sale of the securities). By “Intermediary” it is understood any person whose professional activity consists of carrying out stock exchange transactions.

The tax is levied on the following base:

- for acquisition or purchases, on the sums to be paid by the purchaser after deduction of the brokerage commission;
- for sales, on the sums to be received by the seller or assignor, without deducting the brokerage commission;
- for redemptions of own accumulating shares by a SICAV, on the Net Asset Value (hereafter “NAV”), without any deduction of lump sum charges;

for redemptions of own accumulating shares being “in scope” for article 19*bis* of the Belgian Income Tax Code (i.e. SICAVS with EU passport investing for more than 40% in receivables / debts securities for which a withholding tax is due upon liquidation / redemption of own shares) on the NAV, without any deduction of lump sum charges, but reduced by the withholding tax withheld.

The rate of the tax on stock exchanges transactions varies in accordance with the type of transactions, as follows:

- 0,07 % (subject to a maximum of EUR 500 per transaction) for distributing shares of investment companies, certificates of contractual investment funds (i.e. without legal personality), bonds of the Belgian public debt or the public debt of foreign states, nominative or bearer bonds, certificates of bonds, etc.
- 0,5 % (subject to a maximum of EUR 750 per transaction) for accumulating shares of investment companies, such as SICAVs - 0,17 % (subject to a maximum of EUR 500 per transaction) for any other securities (such as shares).

There are also some specific exemptions from the tax, amongst which the most important ones in practice:

- transactions made for its own account by some financial institutions, such as banks, insurance companies, organizations for financing pensions (OFPs), undertakings for collective investment, etc.;
- transactions made for its own account by non-resident taxpayers.

The tax normally has to be paid by the liable intermediary at the latest on the last working day of the month following the month during which the transaction was executed. The Belgian professional intermediary is liable to pay the tax to the competent Belgian tax authorities. The tax is supported by the person/entity concluding or executing the transaction (the buyer and/or the seller).

Finland

Finland imposes transfer tax on the transfer of certain Finnish securities, mainly equities (e.g. on the basis of delivery of the underlying of an equity derivative), ifthe transferee and/or transferor is a Finnish resident or a Finnish branch of certain financial institutions.

Finnish transfer tax counts on several exceptions, e.g. no transfer tax is payable if the equities in question are subject to trading on a qualifying market (even if the transfer is carried out as an OTC transaction).

Transactions related to equities, profit participating loans and options to subscribe for shares are subject to this tax. However, Finnish transfer tax is applicable to bonds, debt securities and derivatives.

The taxable base of the Finnish transfer tax is the sales price or other consideration. The applicable tax rate is 1.6% and the tax is due upon transfer of the legal title.

Generally, the transferee is liable to pay the Finnish transfer tax, although the broker may also be so in certain cases.

Greece

Greece applies a transaction duty on the sale of Greek listed shares at a rate of 0.15% (0.2% as of 1.4.2011) on the gross sales proceeds. This tax applies to traded financial instruments treated as compound products (equity swaps, call options, futures). The transaction duty, which burdens the seller of the listed shares, is directly withheld upon each settlement of the transaction and paid by the Stock Exchange Depository SA to the competent tax authorities through the filing of a return within the first fifteen days of month following the one within which the transactions took place.

The OTC transfers of Greek listed shares are also subject to the transfer duty of 0,15% on the sale price. The Athens Stock Exchange SA shall collect and attribute the transaction duty through the filing of a return to the competent tax office within the first fifteen days of the month following the one within which the OTC transactions took place. In such case, the connecting factor is the fact that the shares at stake are "Greek listed shares".

Greek transaction duty also applies on the sale of foreign listed shares by Greek tax payers (i.e. Greek resident individuals, Greek enterprises and Greek branches of foreign entities). In such case the seller should pay the duty due by the filing of a return within the first fifteen days of month following the one within which the transactions took place.

Pursuant to a draft tax bill submitted before the Greek Parliament on 21/2/2011, the Greek transaction duty might be abolished for the sale of listed shares initially acquired after 1.1.2012.

Poland

In Poland, the sale or exchange of property rights, which includes securities and derivatives, is subject to the Civil Law Activities Tax (CLAT).

Polish CLAT applies to transactions involving securities and derivatives which grant property rights that are to be exercised in Poland (for instance, Polish securities). If the property rights granted by the securities are to be executed outside Poland but the buyer is established in Poland and the transaction is performed in Poland.

Transactions related to Polish treasury bonds and Polish treasury bills, bills issued by the National Bank of Poland and some other specified securities are not subject to CLAT. OTC transactions, even if they include listed securities, might be subject to the CLAT, even if ransactions executed through an organised market (via stock exchange) are exempt.

The applicable tax is 1% rate on the market value of the securities or derivatives.

As a general rule, the buyer is liable for declaring and paying the tax.

United Kingdom

The UK stamp duty on transfers of securities consists of two instruments: (1) **Stamp duty** (charged on instruments of transfer) and (2) **Stamp Duty Reserve Tax** (SDRT) (charged on underlying agreements to transfer securities where an instrument is not executed).

The two go hand in hand when considering transaction taxes on shares. **Stamp Duties** in the UK are collected on documents used to effect the sale and transfer of ownership in shares and other securities of UK-based companies. In order to collect duties on transactions carried out through electronic share dealing systems, the **Stamp Duty Reserve Tax (SDRT)** was introduced in 1986. Stamp duties are levied on the underlying value of the transferred good. The standard rate is currently 0.5%.

Revenue from duties on the transfer stocks and shares also augmented over the last decade. After the economic downturn in 2001-02 revenue declined for two years in a row. From 2004-05 onwards revenue steadily increased despite the fact that the tax rate remained unchanged at 0.5% in this period. There are three main reasons for this development. Firstly, share prices increased significantly in recent years as a consequence of the economic boom. Secondly, volume of traded shares also increased since the number of incorporated companies increased. Lastly, turnover also augmented since shares have become important products for medium- and short-term investments. However, revenue declined also for this category in 2008-09. The reasons are the reduction in transactions volumes as well as significantly lower stock prices due to the financial crisis. This observation suggests that revenue from stamp duties is pro-cyclical with economic activity. In fact, revenue from stamp duties on transfers of financial assets was more than 30% lower in 2008-09 compared to 2007-08.

The SDRT taxes transactions in shares where no instrument of transfer is executed and which are therefore outside the scope of the "standard" Stamp Duty. In this sense, it is a transaction tax, levied on agreements to transfer chargeable securities while the "standard" Stamp Duty is charged upon documents. SDRT accounts for the majority of revenue collected on share transactions effected through the UK's Exchanges. On average almost 90% of revenues actually stem from the SDRT. Table (B.1) shows the revenue data for both types in the second and third column.[1] The fourth column shows the total revenue from the two sources. The peak is in 2000-01 just before the end of the Internet bubble. Columns 5 and 6 show the tax revenue in relation to total tax revenue and GDP. The Stamp Duty was on average about 0.7% of total tax revenue. In terms of GDP and total tax revenue the highest values have been reached during the boom years at the end of the last century, notably in 2000-01. For 2008-09 the value is back to the level of the mid 1990ies which is around 0.2% of GDP.

Both, SDRT and standard Stamp Duty are levied on share transactions in UK incorporated companies currently taxed at 0.5% of the purchase price of shares. It is charged whether the transaction takes place in the UK or overseas, and whether either party is resident of the UK or not. Securities issued by companies overseas are not taxed. This means that the tax is paid by foreign and UK-based investors who invest in UK incorporated companies. To put it differently, the tax is connected to the location of headquarters.

Table (B.1): Revenue from stamp duties on stocks and shares and other liable securities in the UK

[1] The split between the two levies is only available from 2001 onwards. Note that small differences between values single and sums occur due to rounding when converting revenues in Sterling Pound to Euro.

Year	SDRT	Standard Stamp duty	Stamp Duties Total Revenue	over Total Tax Revenue	over GDP
1995-96	n.a.	n.a.	1,810	0.59	0.20
1996-97	n.a.	n.a.	1,966	0.60	0.20
1997-98	n.a.	n.a.	3,033	0.73	0.25
1998-99	n.a.	n.a.	3,696	0.79	0.28
1999-00	n.a.	n.a.	5,617	1.10	0.40
2000-01	n.a.	n.a.	7,383	1.26	0.46
2001-02	4,218	367	4,586	0.77	0.28
2002-03	3,669	455	4,124	0.69	0.24
2003-04	3,280	418	3,698	0.65	0.22
2004-05	3,454	548	4,001	0.64	0.23
2005-06	4,105	961	5,067	0.77	0.28
2006-07	4,767	745	5,511	0.77	0.28
2007-08	5,372	716	6,091	0.82	0.30
2008-09	3,673	349	4,022	n.a.	0.22
			in m Euro	in %	in %

Source: HM Revenue and Customs and own calculations

Given the existence of the tax, one should observe that investors discount higher future transaction costs when trading shares. These costs should be capitalized in lower share prices. In fact, empirical studies show that the stamp duty influences the share prices negatively. More frequently traded shares are stronger affected than low-turnover shares. Therefore the tax revenue capitalizes at least to some extent in lower current share prices. For firms which rely on equity as marginal source of finance this may increase capital costs since the issue price of new shares would be lower than without the tax. Currently, there are no estimates on the effects on trading volumes and price volatility of the stamp duties in the UK. Given results from empirical studies on the effect of transaction costs on trade volumes it is likely that Stamp Duties reduce trade volumes significantly. Whether or not this increases price volatility is disputed, however, more recent studies tend to find a negative correlation between trade volumes and price volatility.

While it is possible to avoid stamp duty by executing and retaining the instrument outside the UK, in practice the need to get the company's share register changed to show the name of the new owner, combined with the restriction on unstamped instruments being given in evidence

or used for any purpose whatever, means that most instruments of transfer are presented for stamping.

Stamp duty reserve tax is difficult to avoid because the vast majority of UK company shares are held in the CREST settlement system which automatically debits SDRT when they are transferred. Nevertheless, there are two mechanisms to avoid SDRT legally:

American depositary receipts (ADRs)

Many UK companies have ADR programmes which enable them to market themselves in the US. Shares are issued to a US depositary bank which issues "American depositary receipts" (ADRs) in respect of them. It is the receipts rather than the underlying shares that are traded on the US markets. Such trading is currently free from standard 0.5% SDRT transfer charges, but, to compensate, there is a charge instead (only paid once at the higher rate of 1.5%) when the shares are issued to the depositary bank. Placing shares into an ADR system is not regarded as avoidance.

Exchange Traded Fund (ETF)

An overseas collective investment scheme that lists on a UK exchange (ETF) currently qualifies for exemption from SDRT provided that it is not centrally managed and controlled in the UK or has a UK share register. The exemption was introduced in 2007 to encourage overseas ETFs to list in the UK and use of these schemes is thus legitimate. However, owners of an ETF share do not legally own the shares in the fund. If investors want to have voting rights the ETF cannot be used to avoid stamp duty.

Sweden

In the 1980s Sweden experienced strong growth of the financial sector.[2] This was accompanied by significant increases in the salaries of professionals in this sector. It was argued that the financial sector's contribution to the economy and the society was small compared to the resources it used. Furthermore, excessive financial transactions were seen as destabilizing the economy and as promoting disproportionate wage differentials between sectors. The latter point was politically of great importance. Despite the resistance of the Ministry of Finance, Sweden introduced a 50 basis points tax on the purchase or sale of equity securities in January 1984. A round trip transaction (purchase and sale) resulted therefore in a 100 basis points tax. The tax applied to all equity security trades in Sweden using local brokerage services as well as to stock options. The fact that only local brokerage services were taxed is in the literature seen as the main design problem of the Swedish system. Avoiding the tax only required using foreign broker services. In July 1986, the tax rate was increased to 100 basis points. In 1987, the tax base was extended and half the normal rate was also applied to transactions between dealers.

In January 1989, the tax base was widened again and a tax on fixed-income securities was introduced. The tax rate was considerably lower than on equities, as low as 0.2 basis points for a security with a maturity of 90 days or less. On a bond with a maturity of five years or more, the tax was three basis points. Only 15 months later, on 15 April 1990, the tax on fixed-income securities was abolished. In January 1991 the rates on the remaining taxes were cut by half and by the end of the year, they were also abolished completely.

There are different reasons for the abolishment of the tax. First of all, the revenues from the taxes were disappointing. The revenues from the tax on fixed-income securities were expected to amount to 1,500 million Swedish kroner per year, but the average was only around 50 million a year. Furthermore, since trading volumes fell, the capital gains tax became less and less applicable and revenue declined. The increase in revenue from equity transaction taxes was almost entirely offset by this reduction in capital gains taxes. The net budget effect was accordingly close to zero. An additional reason for the decline in revenue from capital gains taxes was the decline in share prices that accompanied the introduction of the transaction tax. The day the tax was announced, share prices fell by 2.2%. Taking into account possible trading based on insider information in the weeks before the official announcement, the price decline is estimated to have amounted to 5.35%. These declines were in line with the net present value of tax payments on future trades. Investors discounted the future payments and prices for equity decreased driving up capital costs accordingly.

Next to the low revenue generated from the tax, relocation became a serious problem in Sweden. 60% of the trading volume of the eleven most actively traded Swedish share classes moved to the UK after the announcement in 1986 that the tax rate would double. 30% of all

[2] The description of the Swedish experience is based on Umlauf (1993) and Campbell and Froot (1993). Sweden levied transaction taxes on stock exchange and stock options, fixed interest securities and the connected derivatives.

Swedish equity trading moved offshore. By 1990, more than 50% of all Swedish trading had moved to London. Foreign investors reacted to the tax by moving their trading offshore while domestic investors reacted by reducing the number of their equity trades.

Even though the tax on fixed-income securities was much lower than that on equities, the impact on the traded volume was much more dramatic. During the first week after the introduction of the tax, the volume of bond trading fell by 85%, even though the tax rate on five-year bonds was only three basis points. The volume of futures trading fell by 98% and the options trading market disappeared. Trading in money market securities, which faced a tax as low as 0.2 basis points, fell by 20%. This reaction was due in large part to the existence of a wide variety of non-taxed substitutes. Once the taxes were eliminated, trading volumes returned and grew substantially in the 1990s.

Singapore

Stamp duty is payable on instruments that give effect to transactions in stocks and shares. Generally, there is no stamp duty payable for derivatives instruments. Stocks are defined in the legislation to include funded debt, which is in turn defined in case law to mean debt with certain features. If a debt instrument is caught by the definition of stock, stamp duty can apply. For share transfers, the duty rate is 0.2% on the amount or value of consideration (and is payable by the buyer).

Share transactions carried out on the Singapore Exchange via the scrip-less settlement system do not attract duty, as there is no instrument of transfer.

Switzerland

A prominent example of a transfer tax outside the EU is Switzerland. A transfer tax (*Umsatzabgabe*) is levied on the transfer of domestic or foreign securities where one of the parties or intermediaries is a Swiss security broker. Swiss brokers include banks and bank-linked financial institutions as defined by Swiss banking law. In addition, companies that own taxable securities of a book value in excess of CHF 10 million qualify as security brokers.

A broker who acts as a party or intermediary in the transaction must pay one half of the transfer tax for himself and another half on behalf of each party who is not a broker. If the broker merely acts as an intermediary, he is only required to pay one half of the transfer tax on behalf of each party who is not a broker. If a Swiss security broker deals at a foreign stock exchange in securities that are subject to Swiss transfer tax, the part of the tax allocated to the other party to the transaction is not levied.

The Swiss securities dealer is liable for the transfer stamp tax and needs to declare and pay his tax liability generally on a quarterly basis.

The taxable base is equal to the consideration paid; if there is no consideration, the taxable base is the fair market value of the security. The duty is levied at a rate of 0.15% for domestic securities and 0.3% for foreign securities.

Bonds, shares in a company's capital and shares in investment funds are taxable securities. Other securities such as options futures, etc. do not qualify as taxable securities for Swiss transfer tax purposes.

There are numerous exemptions to the Swiss transfer tax.

From an objective point of view, Eurobonds, other bonds denominated in a foreign currency and the trading stock of professional security brokers are exempt. Similarly, certain types of transactions are exempt:

- initial purchase of shares in resident companies, including those purchased through a bank or a holding company (subject to stamp duty upon the issuance);
- the transfer of an option to acquire shares;
- the redemption of securities for cancellation;
- the initial purchase of bonds issued by foreign debtors and shares in foreign companies not denominated in Swiss currency;
- the transfer of foreign money market papers; and
- the transfer through security brokers of foreign bonds whether in Swiss or foreign currency between two foreign parties.

From a subjective point of view, the following parties are exempt:

- foreign states and central banks;
- domestic collective investment schemes;
- foreign collective investment schemes;
- foreign institutions of social security;
- foreign banks and securities dealers; etc.

The revenue of the Swiss transfer tax was CHF 1.9 billion CHF in 2007. This corresponds to 0.37% of GDP.

Taiwan

An example for a country with transactions taxes outside Europe is Taiwan. The securities transaction tax is imposed upon gross sales price of securities transferred and the tax rates are 0.3% for share certificates issued by companies and 0.1% for corporate bonds or any securities offered to the public which have been duly approved by the government. However, trading of corporate bonds and financial bonds issued by Taiwanese issuers or companies are temporarily exempt from STT beginning 1st January 2010. The Taiwanese government argued this "would enliven the bond market and enhance the international competitiveness of Taiwan's enterprises."[3] The legal taxpayer is the seller of the securities and tax is collected by the broker or sales agent or the transferee in cases of direct transactions.

[3] See http://www.ey.gov.tw/ct.asp?xItem=65822&ctNode=1334&mp=11 for the press release.

Since 1998, Taiwan also levies a stock index futures transaction tax is imposed on both parties to the transaction based on the contracted amount. The current transaction tax is levied per transaction at a rate of not less than 0.01% and not more than 0.06%, based on the value of the futures contract. Revenue from the securities transaction tax and the futures transaction tax was about EUR 2.4 billion in 2009. The major part of this revenue came from the taxation of bonds and stocks (96.5%). The taxation of stock index future shares was 3.5%. In total, this corresponds to 0.8% in terms of GDP.

2. COUNTRIES EXPERIENCES WITH FAT ELEMENTS

Denmark

Denmark introduced in 1990 a duty on wage and salary costs (*Lønsumsafgift*[4]) for businesses engaged in certain activities that are exempted from VAT. The tax base is generally the sum of labour costs and taxable profit[5]. For several sectors, including financial activities, the tax base is defined as labour costs plus a supplement of 90%.

The base for the payroll tax on financial sector is the sector's total labour costs. Included is any kind of wage payment to the employed including supplements regardless whether they are a wage element or granted separately.

The general tax rate is 3.08%. Specific rates apply to various sectors. For financial services, the rate is 5.08% of labour costs plus an additional 4.5% of 90% of labour costs (i.e. an effective rate of 9.13% (5.08+ 90%*4.5%). This rate will be increased to 10.5% but this measure will not be effective before 2013.

There is no indication that the activity in the financial sector has been reduced as a result of the payroll tax.

As regards the financial sector the effective rate of the payroll tax has been relatively stable at a level of approximately 9 per cent since 1990 when the payroll tax was introduced. The effective rate was unchanged at 8.55 per cent until 1996. From 1996 until 2000 the payroll tax was gradually increased to reach an effective rate of 9.13 per cent in 2000, which has been the effective rate from year 2000 until last year. From 2011 the total burden on the financial sector labour costs are at a 10.5 percent rate. The specific rates of the payroll tax are summarised in table 1.

[4] Covered by the Law on tax o labour costs (lov om afgift af lønsum mv.).

[5] In case of losses, these are deducted from the labour costs. The system is therefore symmetric.

Table 1. Payroll tax rates in the financial sector [1]																							
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Rate on 100 per cent of wages and salary costs	-	-	-	-	-	-	-	4,66	4,82	4,87	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	10,5
Additional rate on 90 per cent of wages and salary costs	-	-	-	-	-	-	-	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	-
Rate on 190 per cent of cent of wages and salary costs	4,5	4,5	4,5	4,5	4,5	4,5	4,5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total effective rate	8,55	8,55	8,55	8,55	8,55	8,55	8,55	8,71	8,87	8,92	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	10,5

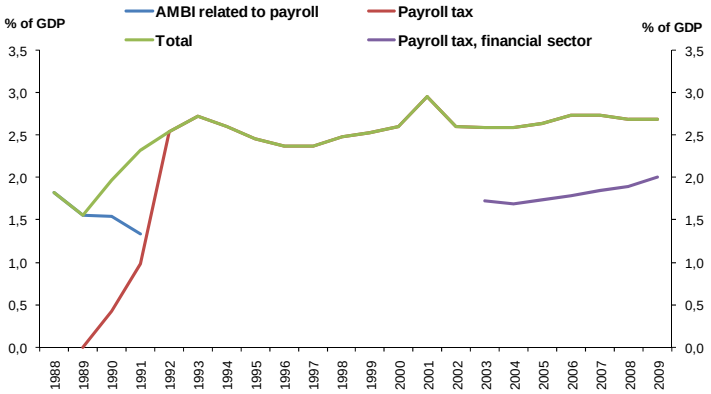
Source: The Danish Ministry of Taxation

Note [1]: Including the AMBI from 1990-1991.

In 2008, the annual revenues amounted to DKK 4,668.7 million (i.e. about EUR 650 million) or 0.26% of GDP. About 70% of this amount would be raised from the financial sector (IMF, 2010). Since the introduction of the payroll tax in 1990 the total tax revenue has been rather constant at the level of approximately 0.25-0.3 per cent of GDP, cf. figure 1. From 1988-1991 a corresponding tax, the AMBI was in effect.

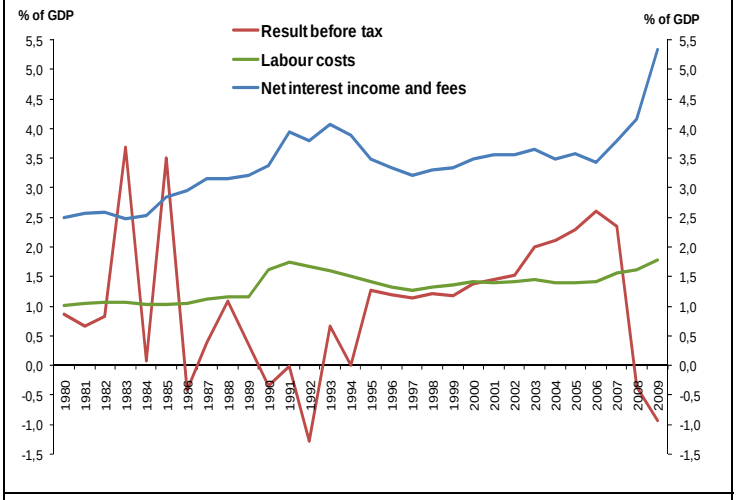
The Danish authorities report that there is no indication that the activity in the financial sector has been reduced as a result of the payroll tax. Measures available for the financial sector activity (pre-tax profits, labour costs as well as net income from interests and fees) do not leave the impression that the payroll tax (or the AMBI) has caused a decrease in financial sector activities cf. figure 2. However, it is not possible to determine what the activity in the financial sector would be in the absence of the payroll tax.

Figure 1. Revenue, Payroll tax and AMBI, all sectors and financial sector, per cent of GDP 1988-2009



Kilde: Danmarks Statistik

Figure 2. Financial sector activity, per cent of GDP 1980-2009



Kilde: Finansrådet og Finanstilsynet.

France

France introduced in 1968 a payroll tax (*taxe sur les salaires*[6]) which is levied on employers who are not liable for VAT or who have not been liable for VAT on at least 90% of their turnover during the previous year. Those include bank and insurance companies. The tax base is defined as gross remunerations, prior to the deduction of employee's national insurance

6 Covered by articles 231 to 231 bis R and 1679, 1679A and 1679 Bis of the General Tax Code.

contribution, including benefits in kind. The measure is therefore not a FAT *per se* but the underlying concept is the same.

For employers who are partly liable to VAT, the payroll tax is due in proportion of the exemption. Remunerations paid by public administrations are exempted as long as this does not create distortions in competition. Remunerations paid to apprentices are fully or partially exempted, depending on the number of employees. A limited number of remunerations are also exempted. Those are mainly paid in the context of training of workers and incentives to hire unemployed. Businesses with a turnover that does not exceed a defined threshold (EUR 80,000 for sales of goods and EUR 32,000 for services) are also exempted.

The tax rate is 4.25%. It is increased to 8.50% for individual annual pay between EUR 7,491 and EUR 14,960 and to 13.60% for individual annual pay above EUR 14,960. There is a reduced rate of 2.95% for overseas territories. The tax is not due if its annual total amount is under EUR 840. If the tax due is between EUR 840 and EUR 1,680, the tax is reduced by an amount representing ¾ of the difference between EUR 1,680 and the tax originally due. Non-profit associations are eligible to a tax credit of EUR 5,890 per year.

The payroll tax is deductible from the corporate income tax or the personal income tax.

In 2008, the annual tax revenues amounted to EUR 11.3 billion. This is about 0.55% of GDP. About 85% of this amount would be levied from financial institutions (IMF, 2010).

Italy

Italy introduced in 1997 a regional tax on productive activities (*Imposta Regionale sulle Attività Produttive – IRAP).*[7] This regional tax is applied to taxpayers engaged in commercial business. The tax base is the value of the net production, which is accounting profit plus most remuneration. Several exemptions apply for unit trusts, pension funds, European Economic Interest Groupings, and some small taxpayers. Deductions are allowed for contributions for labour insurances, expenses related to junior clerks, disable persons and R&D. In addition, there is a EUR 1,850 deduction for each employee (with a maximum of five) to enterprises with income below EUR 400,000 and certain regions apply a EUR 9,200 deduction for each employee. The base is allocated across regions based on the number of workers in each region.

The basic rate is 3.90% and it can be increased by regions up to 1 percentage point. However, since 2008, the rates increased by regions must be multiplied by a coefficient of 0.9176. In 2008, the annual tax revenues amounted to EUR 36 billion or 2.3% of GDP.

China

In China, interest income and capital gain derived from trading of financial instruments should be subject to 5% Business Tax ("BT").

BT is a kind of gross receipt tax similar to Goods and Services Tax ("GST") that is imposed on financial service income. BT covers four categories of financial instruments, i.e. stocks, bonds, forex and others. For the trading of the mentioned four categories of financial instruments, financial institutions are allowed to net off gains and losses arising from trading of one specific category financial instrument within a calendar year for BT calculation purpose. However, for capital gains purposes, the losses and gains from trading of the said four different categories of financial instruments cannot offset against one another.

Interest income, it is generally taxed on gross basis.

The obligation for the payment of BT arises on the day when the taxpayer provides taxable services and receives the business income or obtains the evidence for demanding the business income, unless otherwise specified by the in-charge finance and tax departments under the State Council.

BT should be assessed where the service recipient is located in China, or where the service provider is located in China. Generally speaking, it is the local tax authority governing taxpayers in different locations should collect BT. An entity or individual engaged in provision of services within the territory of China should be a the taxpayer of the BT.

[7] Covered by D. Lg. N446 of 15 December 1997 and L n° 244/2007.

Mexico

As of January 1, 2008, the *Impuesto Empresarial a Tasa Única* (IETU) came into effect in Mexico. This flat rate taxes has as main objective to raise Federal tax revenue.

Taxpayers pay the higher of (i) Mexican IETU, or (ii) Mexican income tax. Although the IETU does not apply specifically to the financial, the Mexican experience with the IETU is worth analysing because it is, in essence, a cash-flow tax.

The IETU taxes business related worldwide receipts from services and from the transfer and lease of goods by Mexican tax residents (individuals and entities) and by non residents with a permanent establishment in Mexico. It excludes most of the exempt organizations under the Mexican income tax law including, among others, authorized charitable organizations and entities with foreign pension fund investments. For the purposes of the IETU, business receipts are those considered as such under Mexican VAT legislation.

Under the IETU, full current deduction of new investments is allowed. New investments made in the last quarter of 2007 may be deducted in a three year period (i.e., 2008 through 2010). Inventories held before January 1, 2008 might be deducted over a 10 year period but with a 60% limitation (this includes Mexican real estate).

Cash payments for taxable concepts are deductible. So it is the non-creditable VAT. Cash receipts and payments for interest and royalties are neither taxable nor deductible. When deductions for one year are higher than taxable receipts, an excess IETU credit is generated that can be credited against any Mexican income tax liability for that same year or carried forward to be applied as a credit against IETU during the next ten years with certain limitations.

A taxpayer can also take a tax credit against the IETU for the following items: (i) income tax paid, (ii) income tax withheld to third parties for items that are deductible for income tax purposes but not for IETU, and (iii) wages and salaries. This is, wages and salaries are not deductible items for the calculation of the IETU taxable base but 17.5% of the wages and salaries can be credited against the calculated tax of the year in order to arrive at a lower payable IETU. This means that some labour intensive entities might not be able to fully credit all the wages and salaries against their payable IETU.

The IETU tax rate is currently 17.5%, although it has progressively increased from 16.5% in 2008 and 17% in 2009.

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Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

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ANNEX 9

TAX ELASTICITIES OF FINANCIAL INSTRUMENTS, PROFITS AND REMUNERATION

REVIEW OF THE ECONOMIC LITERATURE | 28 SEPTEMBER 2011

INFORMED DECISIONS

COPENHAGEN ECONOMICS

COLOPHON

Author:	Partner Sigurd Næss-Schmidt (project manager), economist Eva Rytter Sunesen (team leader), economist Martin Bo Hansen (team member) and analyst Daniel Mekonnen Ali (team member)
Client:	DG TAXUD
Date:	28 September 2011
Contact:	SANKT ANNÆ PLADS 13, 2nd FLOOR | DK-1250 COPENHAGEN PHONE: +45 2333 1810 | WWW.COPENHAGENECONOMICS.COM

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PREFACE

The financial sector was at the root of the financial and economic crisis. This has sparked several policy discussions as to whether there is a need to adapt tax systems to make the financial sector contribute in a fair and substantial way to public budgets.

Some EU Member States have already taken measures with regard to financial sector taxation. Especially the use of so-called bank levies has been adopted. At the same time the EU Commission highlights the importance of implementing such tax instrument in a coordinated framework. If not, different tax systems levied on diverging tax bases could create incentives for tax arbitrage and result in allocation distortions between financial markets in the EU. The emergence of uncoordinated national solutions could also lead to double taxation and fragmentation of the financial sector, hampering the proper functioning of the Single Market.

In order to carry out a debate on the basis of objective data, the European Commission has asked Copenhagen Economics to undertake a study on the tax elasticity and semi-tax elasticity of various tax bases that could fall under the taxation of the financial sector.

This study does not set out to discuss if there is a rationale for adapting the tax system to make the financial sector contribute in a fair and substantial way to public budgets. Also, the study does not intent to provide an in-depth study of the pros and cons of different types of taxation of the financial sector.

The study will be focused on bringing forward all empirical studies that have analysed how the financial sector responds to taxes. We look at responses in three broad areas: 1) their location, 2) their financial activities, and 3) their transactions.

EXECUTIVE SUMMARY

The economic and financial crisis has triggered a massive set of proposed and adopted regulatory measures targeting the financial sector, including higher compulsory contributions in the form of levies, taxes, obligatory insurance schemes etc. Leaving aside the issue of efficiency and effectiveness of such contributions, this study has a much more narrow focus: If tax rates are raised, how much can the targeted tax base, and thus

effective revenues, be expected to be reduced? We carry out the analysis in three steps.

First, we summarise the existing, and not very comprehensive, literature on taxation of the financial sector focusing on the following issues:

Location: There is no strong empirical evidence suggesting that higher tax rates have historically affected the number of financial sector subsidiaries located in the higher tax countries, while the size of the capital allocated to such subsidiaries responds somewhat more.

Taxing profits: There is relatively good evidence showing that banks historically have been able to pass on higher taxes to their customers (e.g. in the form of high lending rates) keeping taxable profits relatively stable. An important exception is banks with substantial international operations, which, to a large extent, have been able to shift taxable profits from high tax regions to lower tax regions.

*Taxing transactions***:** All evidence shows that taxes on specific products such as equities, bonds etc. lead to larger reductions of the tax base than taxes on total profits i.e. reduce the traded volumes of the taxed products. The most important reason is that the financial sector and its customers have a wide variety of means to avoid paying the taxes while continuing the activity in new ways such as packing together new products outside the scope of the tax or simply by moving trade with the existing product to other countries.

Second, based upon recent reviews and as well as other relevant studies on capital mobility more generally, we provide broader recommendations of tax proposals if the aim is to raise significant amount of revenues. Broadness of the tax base is a paramount concern. The tax base should (to the extent possible) cover all products with similar characteristics, be levied on all relevant institutions (not just banks) and should cover as many countries as possible to avoid "leakage" in a financial system that has been dramatically internationalised in recent years. Moreover, taxes on derivative products need to reflect the often wafer-thin profits that are

associated with each trade: even tiny tax rates may make the financial activities unprofitable. The purpose may indeed be to achieve this effect, but the downside is of course that no serious revenues will be collected.

Third, one should be aware that some products with the same broad characteristics might in practice not be equally easy to tax. Derivatives traded on formal trading platforms, for example, are much easier to tax than bilateral over-the-counter products (OTC), implying that equal tax rates on the two types of products may drive trading towards OTC markets. This is at odds with present financial market reforms that attempt to achieve precisely the opposite and that aim to improve transparency in financial markets.

1. MAIN FINDINGS FROM THE LITERATURE REVIEW

This report is about answering a straightforward question: If taxation of the financial sector goes up, what is the resulting impact on the tax base for the particular tax in question? In formal terms this is often referred to as the tax elasticity: A tax elasticity of one means that a 1 percent increase in the tax rate leads to a 1 percent reduction in the tax base. Alternatively, it may often prove useful to use the so-called semi-elasticity approach: A semi-elasticity of 1 implies that a one percentage point increase in the tax rate for example from 10 to 11 percent of the tax base, leads to a reduction of the tax base of 1 percent.

Answering this question is crucial for determining the tax revenues that may result from imposing new taxes on the financial sector. The report provides a review of the existing literature, which can be grouped into three strands according to the possible impact taxes may have on the underlying tax base:

The *first* strand of studies reviews how taxation of financial firms affects the location of their activities (Chapter 2). For example, if the corporate tax rate in the UK is reduced, to what extent will this lead to setting up more subsidiaries in the UK as well as more ingoing FDI to the UK? The answer to this question will allow us to assess what will be the likely increase in the UK tax base.

The *second* strand of studies reviews more directly how taxation on the financial activities affects the relevant tax base (Chapter 3). For example, if Germany increases taxes on banks' profits this may lead to a decline of the tax base as the combined result of:

- Higher funding costs for banks that lead to reduced demand for such services in Germany and therefore result in a lower tax base.
- Activities that are being shifted to domestic non-banking institutions, for example insurance companies, not subjected to the tax.
- Transfer pricing mechanisms that are being used to shift *reported* profits to other jurisdictions while the real underlying activity remains inside German banking sector.
- Underlying real activities being reallocated to other countries, along with the tax base.

The *third* strand of studies focuses on how taxation of individual financial transactions affects the volume of the transactions subject to the tax (reviewed in Chapter 4). For example, if a tax is imposed on financial derivatives traded on formal exchanges in Europe, the revenues from such a tax may be reduced as a result of:

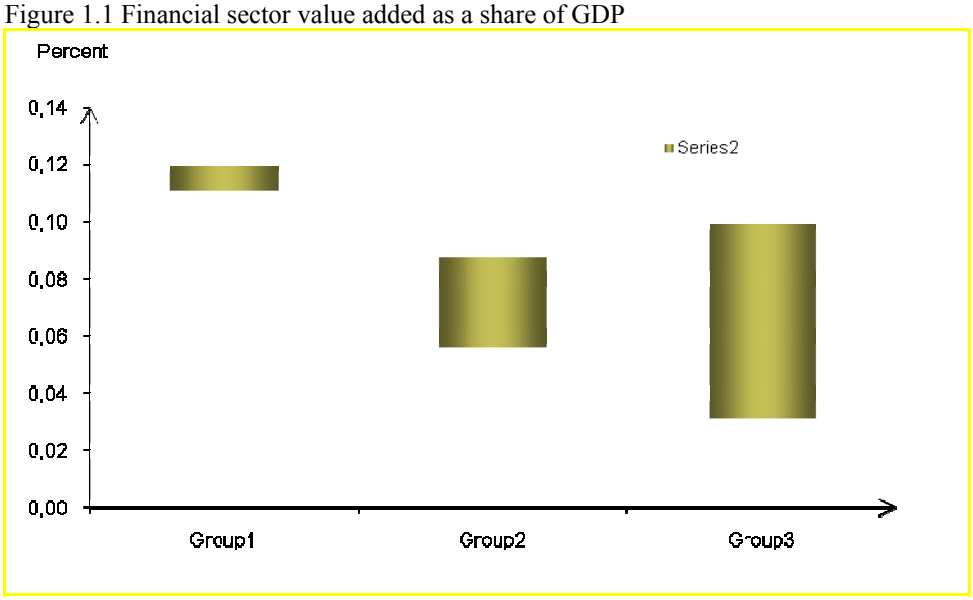
- Less consumer demand for such products.
- Financial innovation i.e. the taxed product being substituted with a "new" product with broadly the same use for the customer but that fall outside the scope of the new tax.
- Demand and supply for such products are pushed towards offshore markets or markets such as OTC products traded directly and bilaterally been the two parties of the transaction which make it more difficult to enforce the regulation of the financial sector.

In this chapter, we outline the overall results of our review along five dimensions: How important is the financial sector (Section 1.1), reported tax elasticities from the literature (Section 1.2), identification of major shortcomings in the literature (Section 1.3), learning points from broader studies of capital mobility (Section 1.4) and our overall conclusions (Section 1.5).

1.1. Importance of the financial sector

To get a feeling for the potential gross revenue from taxing financial institutions and their activities, some stylised facts about the financial sector's relative importance in the overall economy is warranted. Measured by value added, the share of the financial industry varies across countries. The share in countries such as Cyprus and UK (in group 1)makes up app. 11-12 per cent of GDP, whereas it can be as low as 3-4 per cent in countries such as Slovenia and Hungary (in group 3) cf. Figure 1.1.

Figure 1.1 Financial sector value added as a share of GDP

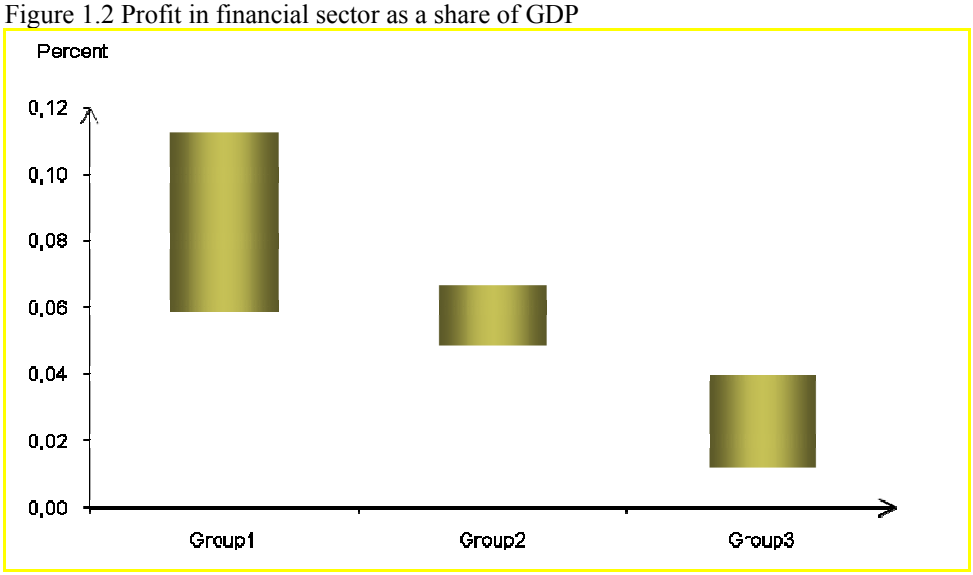


Note: Financial sector excluding insurance and pension funds. Group1 = Cyprus and the UK. Group 2 = the Netherlands, Denmark, Spain and Estonia. Group3 = Bulgaria, Italy, Portugal, Greece, Sweden, Finland, France, Lithuania, Belgium, Hungary and Slovenia.

Source: Eurostat.

The same pattern is reflected in the shares of gross financial profits as share of GDP, which is a proxy for the operating surplus of financial institutions cf. Figure 1.2. Variation across groups of countries can to a large extent be explained by the importance of financial centers in Luxembourg, the UK, Ireland and Cyprus. These financial centres provide services largely for non-domestic customers in such areas as investment banking and fund managements.

Figure 1.2 Profit in financial sector as a share of GDP



Note: Financial sector excluding insurance and pension funds. Variation in country groups between Figure 1.1 and Figure 1.2 is due to lack of available data. Group1 = Luxembourg, Cyprus and Ireland. Group2 = the Netherlands, Denmark, Spain, Latvia and Estonia. Group3 = Bulgaria, Italy, Portugal, Greece, Sweden, Finland, France, Lithuania, Belgium, Hungary, Slovenia and Austria.

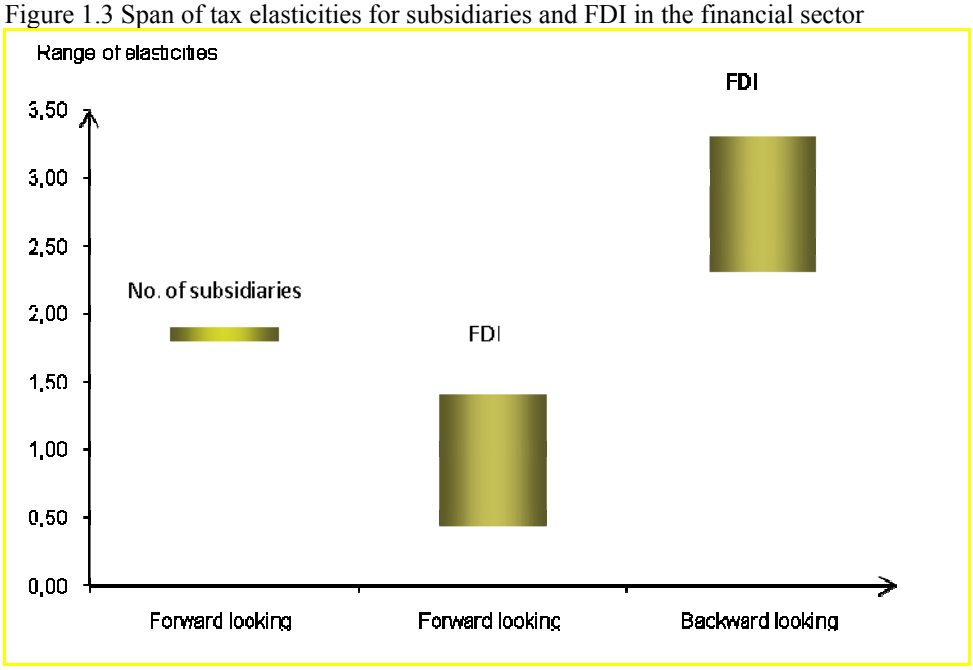
Source:Eurostat.

The difference between servicing mainly domestic and non-domestic customers has two important implications for potential tax revenues. First, the immediate potential impact of taxes on financial activities may differ substantially across countries. Second, it is highly unlikely that tax elasticities are equal across countries for the same broad category of taxes: the composition of banking services and other financial institutions in the UK and Luxembourg, for example, differs substantially from the composition in say Sweden or Italy. As discussed later in the report, investment banking and fund management are much more mobile activities. Hence, taxes on such activities are more prone to "leakage" in terms of dislocation of activities to other tax jurisdictions.

1.2. Available evidence from studies on the financial sector

The available studies on the location of financial companies suggest that the total flow of FDI is less responsive to tax changes than the number of subsidiaries within the financial sector. Both measures are a proxy for the location of companies. While the number of subsidiaries in a country increases by 1.8 to 1.9 percent by a 1 percent reduction in the forward looking tax rate, FDI increase by between 0.4 to 1.4 percent cf. Figure 1.3.

Figure 1.3 Span of tax elasticities for subsidiaries and FDI in the financial sector



Source: Copenhagen Economics.

However, the elasticity of FDI seems to be very dependent on whether the studies have used a forward or backward looking tax rate, cf. Box 1.1. The higher relative elasticity of FDI with respect to the backward-looking tax rate is perhaps not surprising given the discrete choice nature of the decision of firms with an international outlook. First, they decide on whether to set-up subsidiaries in a foreign country. Second they need to decide on how much capital to invest in such subsidiaries. A lower rate of taxes in a jurisdiction will hence lead to both more subsidiaries with a resulting increase in FDI in these new subsidiaries *and* more FDI injected into existing subsidiaries.

Box 1.1 Forward and backward looking tax rates

Forward looking rates are the (hypothetical) rates that firms are facing. The literature commonly uses statutory tax rates (STR) and effective tax rates such as the effective average tax rate (EATR) and the effective marginal tax rate (EMTR). Statutory rates can be interpreted as the "face value" that companies face. STR's do not include e.g. tax base differences such as depreciation deductions, government tax compensations, etc. Effective rates take account of various available deductions and other tax base differences, and the tax rates are calculated as the net present value of tax payments as a share of the net present value of pre-tax income using tax rules. The EATR determines the impact on infra-marginal investment decisions whereas the EMTR measures the incentive at the margin of the investment. When it comes to firm localisation and the discrete investment decisions dealing with whether to invest abroad or not, the average effective tax rate is therefore probably the most relevant tax measure (see also Devereux and Griffith, 2003). On the other hand, for marginal decisions when investment is already in place, effective marginal rates are more appropriate.

Backward looking rates, such as the average tax rate (ATR) are based on firms' actual tax payments and therefore include countries different tax base definitions. These measures, however, are based on past tax rates and do therefore not give a good picture of the actual decision facing the firms in respect to countries' current tax system. Backward-looking rates are therefore used less frequently in the empirical literature.

Source: Copenhagen Economics.

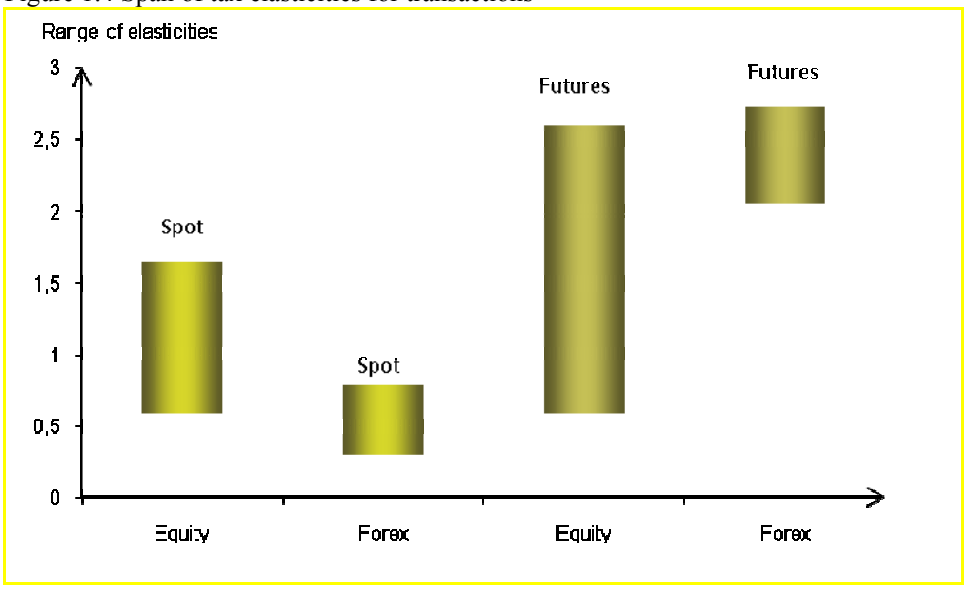
Available evidence in the literature on financial activities suggests that taxes on profits are largely shifted on to customers, implying rather low tax elasticities. One study covering the US, the UK and the eight euro area countries in the period 1980-2003 shows that the costs of higher taxes lead to a roughly 90 increase in pre-tax profits due to lower operation costs (partly lower service) as well as higher net interest. A recent overview study broadly confirms this picture. The implication in this context is that increased taxation of the financial sector is likely to make lending more costly.

However, there is also evidence that multinational banks tend to respond aggressively to taxes by shifting financial activities to other jurisdictions. This is likely to be associated with two factors. *First*, multinational banks have more potential for tax shifting in terms of reporting taxable profits in tax jurisdictions with beneficial tax regimes (transfer pricing). *Second*, the activities of multinational banks in a given tax jurisdiction cannot be compared with domestic banks primarily with a national focus, serving households, small and medium sized enterprises etc. Indeed, the main focus of international banks setting up subsidiaries in other countries is to offer more sophisticated products and services, wholly or partly "produced" by headquarter functions and hence more likely to be subjected to transfer pricing mechanisms.

Finally, the available evidence in the literature of financial transactions suggests that the highest elasticities are found for taxes on financial transactions particularly on futures transactions, cf. Figure 1.4. Assets

such as equity or foreign exchange can be traded both on the spot market (where the transaction takes place immediately), and on the futures (or forward) market where a transaction in the future is agreed upon. There is evidence that the recent growth in futures trading, especially of foreign exchange, to a large extent is driven by arbitrage trading e.g. in the form of high frequency electronic trading such as algorithmic trading.[1] This type of trading, where profit opportunities, liquidity management or risk hedging are the goals of the transaction more than conducting a real economic activity, is expected to be more responsive to changes in transaction costs.

Figure 1.4 Span of tax elasticities for transactions

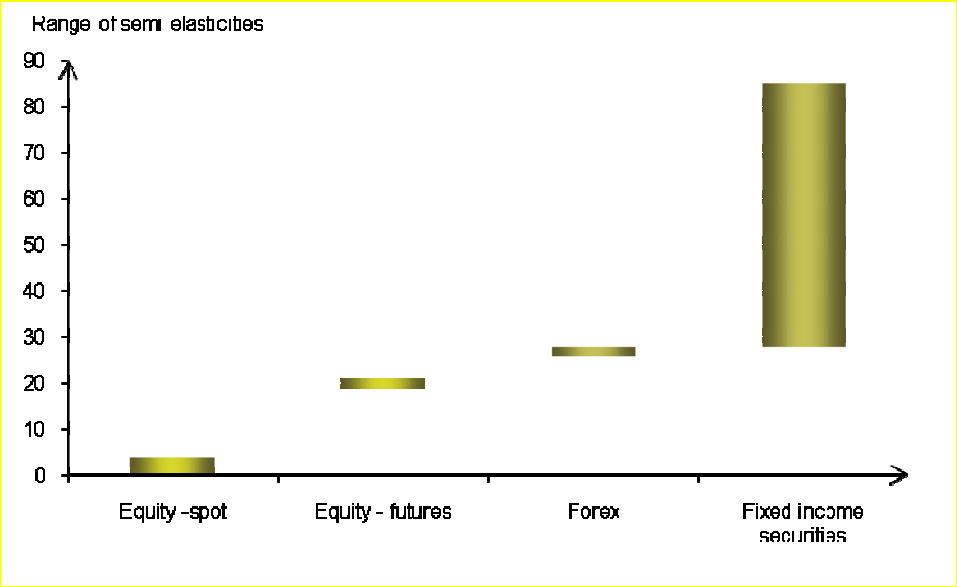


Source:Copenhagen Economics.

The level of financial transaction elasticities should also be held against the fact that most financial transaction taxes studied in the literature (especially on trading derivatives such as futures) are very low. A more precise picture can be achieved by looking at the semi-elasticities of transaction taxes. The potentially huge responses to transaction taxes become evident when semi-elasticities are studied cf. Figure 1.5. The literature highlights cases where even very small tax increases (a few basis points) have resulted in volume reductions of up to 85-98 percent.

[1] See e.g. BIS Quarterly Review December 2010.

Figure 1.5 Span of tax semi-elasticities for transactions – tax increase of 0.01 percent



Note: The semi elasticities in this figure measure the percentage decrease in volume as a response to a tax increase of 1 basis point (0.01 percent).
Source:Copenhagen Economics.

1.3. Serious shortcomings identified

It is hardly possible to overstate the shortcomings of the existing literature in terms of providing reliable and comparable revenue estimates from higher taxes on financial sector activities, cf. Table 1.1. A number of shortcomings are highlighted below:

1) There are only few studies that focus explicitly on financial sector issues especially in the literature of location and profits. In total, we have identified 18 studies of which only three cover the location of firms and two studies cover effects on tax shifting on profits.

2) Most studies are either quite old or consider time periods of little current interest, especially bearing in mind the transformation and globalisation of the financial sector over the last decades. There has been a large growth in certain kinds of products designed to exploit extremely small profit opportunities from arbitrage. These products, e.g. derivatives trading on electronic platforms, crucially rely on very small transaction costs, which have been driven down by the progress in IT. Yet very few studies have been carried out with data after 2000.

3) Only a few studies consider the possibility of changing elasticities due to time trends. As will be discussed below, other studies more broadly on capital mobility have identified a trend of increased capital mobility over time. Yet just three of the studies

reviewed have attempted to identify such trends. This suggests that average estimated elasticities for the entire period underestimate the current size of the tax elasticity.

4) There is a problem with the functional form in most of the empirical work. Basically, the approach used almost forces the *measured* responsiveness of the tax base to be high when initial tax rates are low and vice versa. This has the effect that an increase in the tax rate from 1 to 2 percent often will be estimated to have a 10 times larger effect on the tax base than an increase from 10 to 11 percent. This appears highly counter intuitive in a number of cases.

5) Apart from studies on the number of subsidiaries, no studies focus on the possibilities of "discrete jumps". Once a tax exceeds a certain threshold, dislocation/tax shifting is not marginal but complete. This means that the entire activity is moved abroad or discontinued. This may for example be relevant for taxes on arbitrage related trading of derivatives where profits per trade are wafer thin, hence tolerating only very low tax levels to remain profitable.

6) The used estimation methods often fail to capture longer-term effects. In particular, changes in relative tax rates between countries affect incentives to invest, but that will only be reflected in the capital stock over time as firms make new investment decision.

7) There is a shortcoming regarding the level of aggregation in the studies. Some studies review effects of taxes on the entire financial industry, not just banking, while none specifically review differences in the tax responsiveness across different segments of the banking industry. As suggested above, we would expect the tax responsiveness to be substantially larger for investment banking and fund management than for retail banking directed at households and smaller firms.

Table 1.1 Nine shortcomings in the existing literature on financial sector tax elasticities

Summary		Elasticity of location	Elasticity of pre tax profit	Elasticity of financial transaction
Number of studies		3	2	13
Time period analysed	Before 1980	0	0	1
	1980-1990	0	1	3
	1990-2000	3	1	7
	2000+	0	0	2
Explicit modelling of time trends in elasticities		0	1	2
Elasticity approach		3	0	13
Semi-elasticity approach		1	2	0
Explicit modelling of discrete jumps		0	0	0
Estimation methods ability to capture long-term effects		0	0	4
Explicit focus on banking sector		0	2	n.a.
Separation of retail, commercial, fund management and investment banking		0	0	n.a.

Source: Copenhagen Economics based on literature review.

1.4. Learning points from some other studies

Bearing in mind the limitations of the specific literature on financial sector related activities, we have included in our study some learning points from other studies on capital mobility that do not consider the financial sector isolated:

- Recent meta-studies show that the responsiveness of FDI has risen over the last decades reflecting the same factors that have driven globalisation more generally. These factors are reduced costs of communications and transportation as well as trade liberalisation. Given the explosion in financial activity after 1995 this is a significant conclusion. As most of the studies on the financial sector consider a time period prior to this, we expect the responsiveness of the financial sector to be increasing over time.

- Historically, financial sector "innovation" (also known as regulatory arbitrage) has been quite effective in undermining the intended effects of financial market regulation. Indeed, this is one of the risks that have been highlighted in the context of the present discussion on reform of financial market regulation. If the costs of providing a financial transaction in any particular form become too high, activities will move to unregulated entities or other jurisdictions underlining the likely non-linear nature of the effects of taxes on the underlying tax base.

1.5. Overall assessment

Our overall assessment on the responsiveness of the tax base to higher tax rates can be summarised in three main statements.

First, taxes on bank profits are largely borne by the customers in terms of higher funding costs and/or lower services, implying a relatively stable tax base and low tax elasticity. For financial centres, where a substantial part of total banking profits is derived from servicing clients at regional/global level, the picture may be more complicated. The location of such activities is based on a larger assessment of the attractiveness of the location in terms of the underlying infrastructure, economics of scope and scale, quality of regulation, language as well as broader framework conditions. Indeed taxation of highly paid staff may be as important as taxation of profits. Minor changes in business taxation may not have substantial effects while larger changes may lead to a complete relocation to other potential financial centres.

Second, for transaction taxes, even though the estimated tax elasticities are quite large there are substantial reasons to believe that more than marginal increases in tax rates may have even larger effects. This is due to the shortcomings in the literature as discussed above. Rather than relying on a mechanistic use of old elasticities it may prove worthwhile to study the economics of any given increase in the tax rate more carefully especially in a modern financial setting.

Third, the broader the tax base is, the smaller the tax elasticity will be. This has several dimensions. The tax base needs to cover all products that are near substitutes as well as institutions that can produce such goods. The latter is important as a number of financial products can be provided by non-banks as well as non-financial institutions. The most obvious example is household credits, which are provided by a myriad of suppliers. Also, the tax base should be applied to as broad a geographical area as possible to avoid that the tax base shifts across borders.

2. TAXES AND THE LOCATION OF FINANCIAL COMPANIES

Like any other investor, financial companies have to weigh the costs and risks of going abroad against the opportunities for making business at home. Financial companies may establish foreign subsidiaries to follow their customers and provide them with financial services abroad.[2] Financial companies may also expand abroad to seek new, local market opportunities and to increase profitability. High effective tax rates may affect that decision and make an investment location less attractive by increasing the required rate of return on the investment.

Financial companies also weigh the costs and risks of going abroad against other modalities to provide services across borders without establishing a fully fleshed local presence. Banks, for example, may do this by offering cross-border lending. New technological and IT advances have made financial companies increasingly able to provide many types of financial services across borders without needing to establish foreign branches (e.g. through the increasing use of net banking). Large tax differentials may therefore lead to a concentration of financial activities in low tax locations.

In essence, the choice of location of a financial institution is linked to the more general issue on how firms can slice up their activities and optimise all elements in their value chain: the optimal choice is affected by the underlying costs and benefits of trading at distance from the customers being served.

In this chapter we summarise the theoretical and empirical findings on the relationship between taxes and the location of financial companies. In Section 2.1 we sketch out how taxes may impact the location of financial companies, and we point out aspects of the location decision that need to be addressed in the empirical setup. In Section 2.2 we summarise the main findings in the empirical literature on the location decision of financial companies. In Section 2.3 we examine whether financial companies are more responsive to taxes than multinational companies in other sectors. In Section 2.4 we draw policy lessons from a broader set of empirical papers on FDI in other sectors, and in Section 2.5 we provide some concluding remarks.

[2] See Claessens and Van Horen (2008) and references herein.

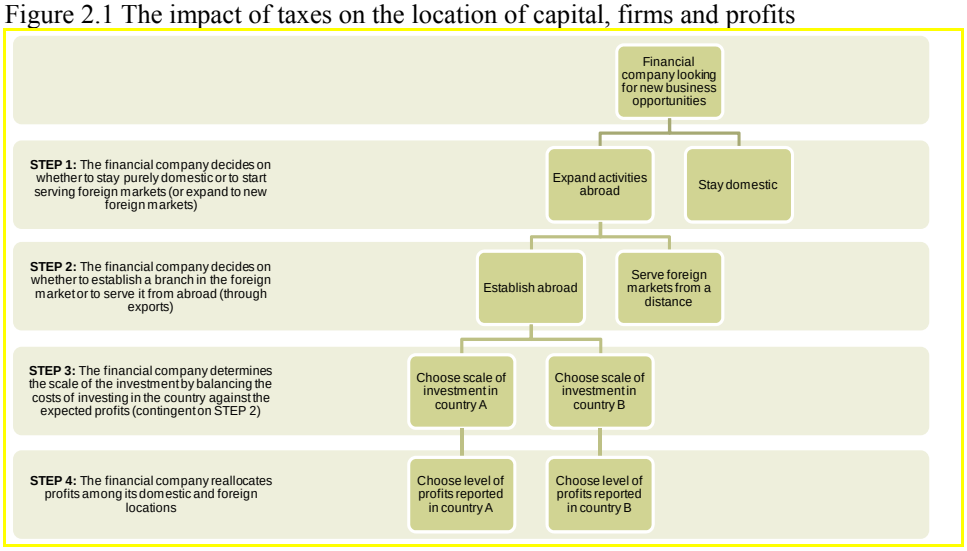
The literature review draws mainly on empirical studies that are directly relevant for financial companies (such as the banking sector) but due to the lack of relevant studies we also draw on a broader set of studies including the tertiary and service sectors. We do not select individual studies that base their analysis on other sectors but we chose to include the findings in two recent meta-analyses with a broad coverage of sectors. We do so in order to close some of the gaps in the empirical literature.

2.1. How taxes impact the location of financial companies

The decision of where to locate headquarters and foreign subsidiaries of a financial company can be characterised by a four-step procedure, cf. Figure 2.1.[3] *First*, the financial company decides whether to stay purely domestic or to look for new business opportunities in foreign markets (or in new foreign markets if the financial company has already establishments abroad). *Second*, conditional on choosing to establish abroad, the company must decide where to locate its foreign affiliate (country A and country B in the example). The first two steps are therefore discrete location choices, where taxes (and other location factors) may have an impact on the number of foreign establishments in country A and country B. *Third*, foreign companies face a flow decision on how much to invest in the two countries. Here, the impact of taxes will be recorded in the amount invested and therefore in the stock of inward FDI in the financial sector in country A and country B. And, *fourth*, the company has a choice of where to locate its profits (if any). This will be discussed further in the next chapter.

[3] See Devereux (2007) for more details.

Figure 2.1 The impact of taxes on the location of capital, firms and profits



Source: Copenhagen Economics adapted from Devereux (2007).

It is important to keep in mind that the responsiveness of financial companies to taxes may be different in the two decisions, and this is an aspect, which should be taken into consideration in the specification of the empirical model.

First, the dynamics is likely to be different in the two steps since it will take longer to adjust the location of foreign affiliates to tax changes compared to adjusting the amount of money to be invested in a particular location. The responsiveness of the number of foreign establishments may therefore be higher in the long run than in the short run, whereas no major difference is expected in the way FDI flows respond to taxes in the short and the long run.

Second, the impact of taxes on the location of financial companies is likely to depend on the type of services the company provides since some types of financial activities are more mobile than others. For retail banking, *on the one hand*, location of branches close to customers is often required, and tax changes may therefore have a relatively low impact on location of such branches.[4] Capital fund management and investment

[4] This is very much in contrast to manufacturing companies where exports typically account for a very large share of revenues and, consequently, local cost conditions are relatively more important than the local market potential.

banking activities, *on the other hand*, are less dependent on being located close to the client. Instead, location is very much driven by supply economics (such as economics of scope and scale, taxation levels of employees and wider scope of relevant support services being provided such as strong legal and accountancy environment). Such activities are typically concentrated in financial centres and large financial companies, and the tax base is expected to be relative insensitive to small tax changes but very elastic to large tax changes (relative to competing financial centres). Examples of such financial centres within the EU are London for investment banking and Luxembourg for fund management. Also, technological advancements have made it easier to serve customers in more distant markets, which will tend to make such financial activities more responsive to taxes over time.

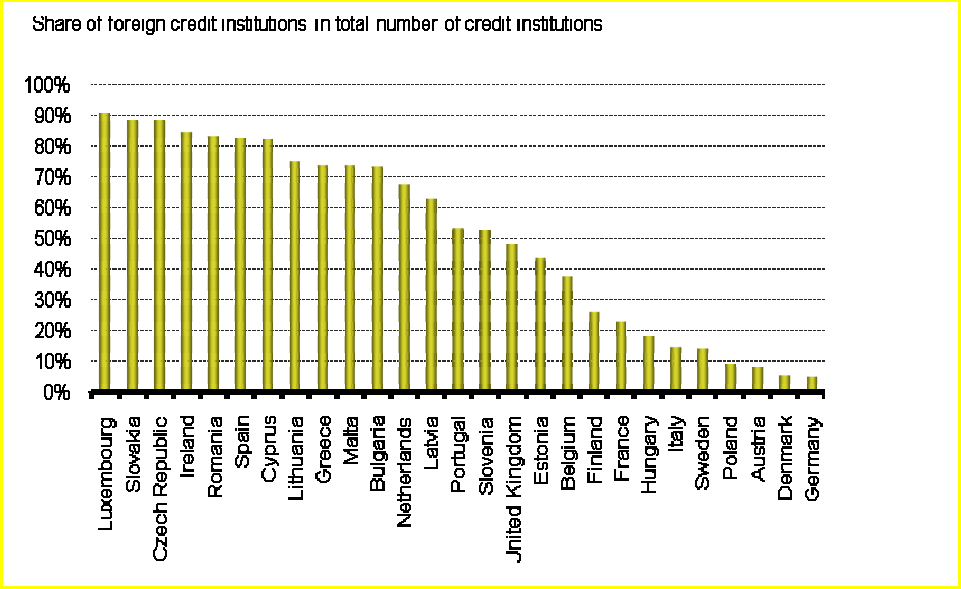
2.2. Impacts of taxes on the location of financial companies

In the empirical literature examining the impact of taxes on the location of financial companies, location is either proxied by the number of foreign companies located in a particular country or by the amount of inward FDI flowing to a particular location. Before moving on to the empirical findings we shortly provide some descriptive statistics on the two dependent variables applied in the literature.

2.2.1. FDI in EU countries

The penetration of foreign companies in the financial sector varies very much across countries. Luxembourg, Ireland, Cyprus and Malta have a high share of foreign subsidiaries in the financial sector (proxied by the number of credit institutions), cf. Figure 2.2. In Ireland, an explanation for the high number of foreign subsidiaries could be that FDI in the secondary and tertiary sectors has historically been taxed at a lower corporate tax rate than investments in the primary sector. The arguments put forward are that there are large technological and knowledge spillovers from these sectors. Some of the new Member States also turn out to have a high penetration of foreign financial companies who have established themselves during the last decade and have therefore contributed to the expansion of the financial infrastructure in these countries. Financial companies in Germany and Denmark face the least competition from foreign subsidiaries.

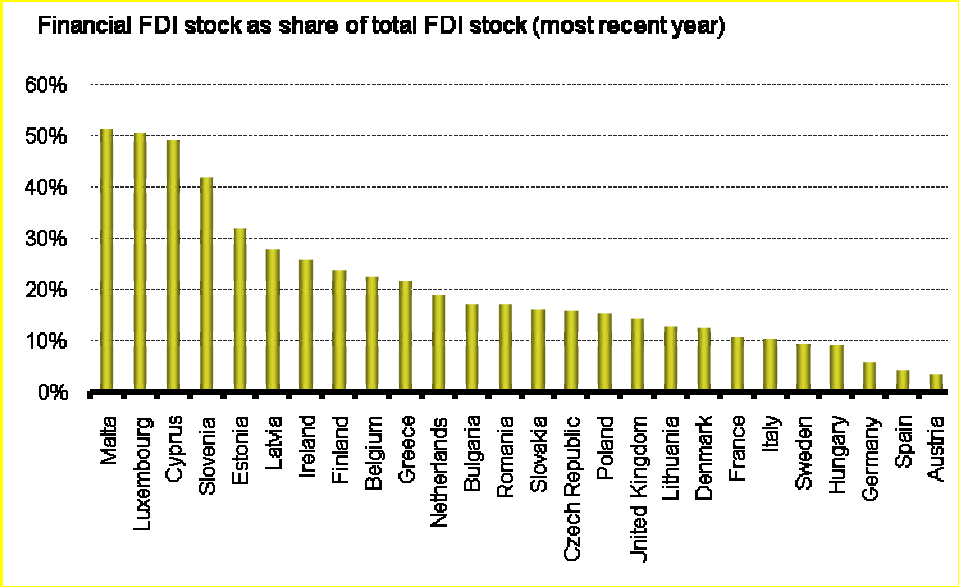
Figure 2.2 Large differences in the penetration of foreign financial companies



Note: Data is from 2010.
Source:European Central Bank, Statistics on Consolidated Banking Data.

We also find that the countries that host many financial companies are also the countries that have a large share of their inward FDI stock stemming from the financial sector. Around half of the inward FDI stock in Malta, Luxembourg and Cyprus has been invested in the financial sector, cf. Figure 2.3.

Figure 2.3 The stock of inward FDI in the financial sector



Note: The financial sector is defined as financial intermediation, except insurance and pension funding (NACE code K64). The data are from the most recent year, which is 2009 for most countries except for Belgium, Bulgaria, Czech Republic, Germany, Estonia, Greece, Spain, Luxembourg, Hungary, Slovakia, Sweden (year is 2008) and Italy, United Kingdom (year is 2007). Portugal is missing due to lack of data on FDI in the financial sector.

Source: Eurostat, Balance of Payment statistics.

2.2.2. Learning point 1: Financial companies are very responsive to taxes

In this section we summarise the response of the location of financial institutions to changes in taxation. To the extent possible we report both semi-elasticities and elasticities. The elasticity measures the percentage change in FDI in response to a 1 percent change in the tax rate, e.g. a decline from 30 percent to 29.7 percent. The semi-elasticity measures the percentage change in FDI in response to a 1 percent point change in the tax rate, e.g. a decline from 30 percent to 29 percent. It is defined as $\partial \ln(FDI)/\partial t$. Transforming elasticities into semi-elasticities requires data on the mean value of the FDI variable. Moreover, transforming elasticities into semi-elasticities requires data on the mean value of the tax rate. This data is not always available in which case we only report the measure provided in the paper.

Optimally, we are looking for studies that estimate the tax elasticity of the location of *financial companies*. However, only few studies have looked specifically at the financial sector, and we therefore broaden our scope to the tertiary/service sector, which has been the focus of a larger range of studies. Besides financial services, the tertiary/service sector also involves transport, distribution, sales activities and the provision of other services.

Since the focus is on people interacting with people and serving the customer rather than transforming physical goods we find that this approximation seems reasonable. Details of the papers (methodology, tax measure, sectors, elasticities and conclusions) can be found in Table 2.1. The key findings are summarised underneath.

Table 2.1 Impact of taxation on the location of financial companies

Study	Methodology	Tax measure	Elasticity in the financial sector	Elasticity in other sectors	Conclusions
Overesch and Wasmer (2009)	Poisson regression using count data on the number of German outbound FDI in 30 EU countries in 2005	STR and EATR	STR (EATR) elasticity of -1.8 (-1.9) and a semi-elasticity of -5.8 (-6.6) in the financial sector	STR (EATR) elasticity of -0.8 (-0.7) and a semi-elasticity of -2.5 (-2.4) across all sectors	FDI is inversely related to tax rates and the effect is asymmetric across sectors
Stöwhase (2005a)	Panel data regression on bilateral FDI from eight EU countries to Germany, the Netherlands and the UK during the period 1995-1999	EMTR	STR (EATR) elasticity of -2.3 (-0.4) in the tertiary sector	No tax response in the primary sector. STR (EATR) elasticity of -1.4 (0.3) in the secondary sector	Irrespective of the tax measure, the tax elasticity of tertiary sector is 20% to 30% above the average elasticity
Stöwhase (2005b)	Count data regression on the number of German MNEs in Austria, Belgium, France, Ireland, Italy, the Netherlands, Spain and the UK during 1991-1998	STR and EATR	STR elasticity of -6.6 in the service and finance sector. No response to EATR	EATR elasticity is -2.0 in the production sector. No response to STR	Separation of different types of FDI has an impact on the tax elasticities, where the STR affects service and finance while EATR affects production sector

Note: ATR=Average tax rate, ETR=Effective tax rate, EMTR=Effective marginal tax rate, EATR=Effective average tax rate and STR=Statutory tax rate. When possible, missing elasticities and semi-elasticities have been calculated using mean tax/FDI data across the sample countries and years.

Source: Copenhagen Economics.

In the *first* group of studies the location choice is defined as a discrete choice where the investor decides where to establish a foreign subsidiary. The elasticity in this case measures the percent change in the number of foreign subsidiaries when the tax rate is cut by 1 percent. Irrespective of the tax measure applied, we find that the number of subsidiaries drops when the tax rate increases, cf. Table 2.2. When the tax rate increases by 1 percent, the number of foreign subsidiaries drops by an average of 2 percent irrespective of whether the tax measure being used is the statutory tax rate (STR) or the calculated effective average tax rate (EATR). This elasticity transforms into a semi-elasticity abound 6 percent. In the UK, for example, using a tax semi-elasticity of 6 percent causes the number of foreign subsidiaries in the financial sector to drop from 89 to around 84 if the tax rate increases one percent point.

Table 2.2 Elasticity of the location of financial companies

FDI location indicator	Tax rate measure		Elasticity	Semi-elasticity
Number of subsidiaries	Forward looking	STR	-1.8	-5.8
		EATR	-1.9	-6.6
Bilateral FDI flows	Forward looking	ETR	-0.43; -1.4	
	Backward looking	ATR	-2.3; -3.3	

Note: STR=Statutory tax rate, ETR=Effective tax rate, ATR=Average tax rate, EATR=Effective average tax rate and EMTR=Effective marginal tax rate.

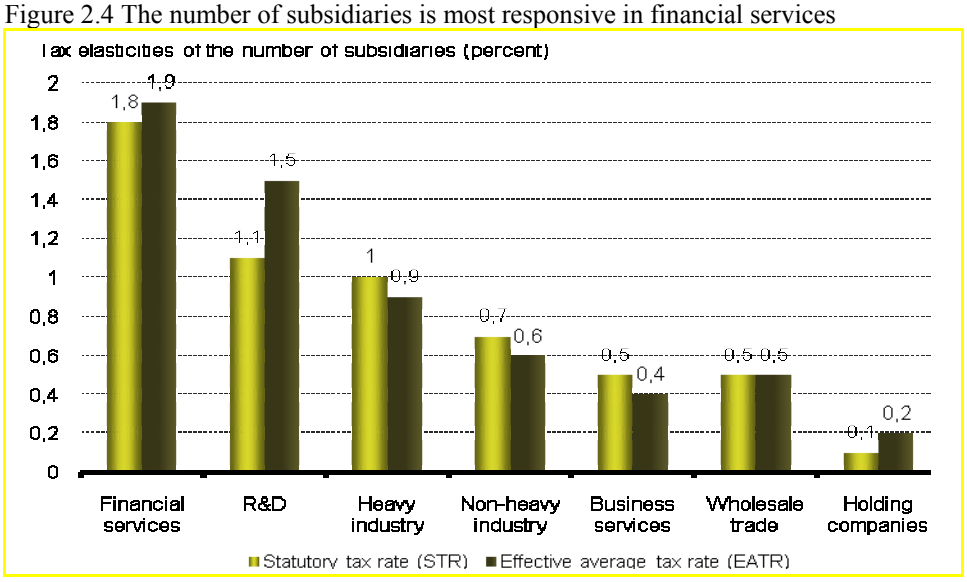
Source:Stöwhase (2005a, b) and Overesch and Wamser (2009).

In the *second* group of studies, the location decision is defined as a continuous choice where the investor decides on how much to invest in a particular country. The elasticity in this case measures the percent change in the amount of bilateral FDI when the tax rate differential increases by 1 percent. We find that inward FDI responds negatively to higher tax differentials between the host and the home country but the size of the impact depends on the applied tax measure. We find that bilateral FDI on average decreases between -0.4 and -1.4 percent when the measured effective tax rate (ETR) difference drops by 1 percent. The drop in bilateral FDI flows is around -2.3 and -3.3 percent when the average tax rate (ATR) difference drops by 1 percent, cf. Table 2.2.

2.2.3. Learning point 2: Financial companies are more sensitive to taxes than non-financial companies

Financial companies also appear to be much more responsive to taxes than companies in a broad set of other sectors, cf. Figure 2.4. The tax elasticity in financial services is around -2, which is almost twice as high as the tax elasticity in the second most responsive sector (R&D) and almost 10 times as large as the tax elasticity in the least responsive sector (holding companies). The implication is that empirical papers using a broad set of sectors tend to underestimate the tax responsiveness of companies in the financial sector.

Figure 2.4 The number of subsidiaries is most responsive in financial services



Note: The dependent variable in these regressions is the number of subsidiaries in seven sub-sectors.
Source:Overesch and Wamser (2009).

2.2.4. Shortcomings in the empirical literature on the location of financial companies

There are a number of shortcomings in the empirical literature that should be kept in mind:

- **Number of studies:** The limited number of studies is in itself a problem since it puts a limit to the number of comparative analyses and firms conclusions one can draw from these studies. To our knowledge, there are only three empirical studies that are directly applicable to financial sector taxation.[5]
- **Time period:** Tax elasticities in the financial sector may not be constant over time (e.g. due to technological advantages) which would indicate that regressions may be prone to structural breaks and time dependent elasticities. Most studies use data stemming from a period before 2000, and this should be kept in mind when such tax elasticities are extrapolated and used in regulatory impact analyses.

- **Dynamics:** Financial companies may in some cases take time to adjust their location to tax changes. This may particularly be the case in the discrete location decision. The empirical methodologies referred to in this chapter do not distinguish between short and long-term responses but only reflect annual changes in location.

[5] The three studies are Stöwhase (2005a, b) and Overesch and Wamser (2009).

- **Composition of activities:** The elasticities reported are for the financial sector as a whole (or in some cases for the tertiary/service sector) but different activities can be expected to respond differently to tax changes (e.g. retail banking vs. capital fund management). This has at least two implications. *First*, tax elasticities may not be uniform across countries even in the absence of other influencing factors as a whole since individual countries have different financial sector composition. *Second*, tax elasticities may not be uniform across financial companies but will depend on the exact activities carried out in the companies and possibly also on the size of the company. None of the empirical papers summarised in this report provide the necessary level of detail in this regard.

- **Composition of countries:** The samples used in the empirical literature include only a small number of countries (typically old EU Member States), which provides very little variation in the attractiveness of the different investment locations. When there is little variation across observations it becomes difficult to draw interference based on statistical analysis.

Due to these shortcomings, the empirical tax elasticity will reflect an average of several elasticities that may lie in a broad interval. To cover some of these caps, we draw on a broader set of empirical studies of the location decision of foreign investors. However, one should keep in mind that the results may not be directly applicable to financial companies.

2.3. Drawing lessons from a wider set location studies

Rather than going into details with individual studies of empirical tax elasticities, we draw mainly on the findings in two recent meta-analyses of FDI and taxation which we find relevant for the discussion of the location of financial companies, not the least to cover some of the shortfalls identified above, cf. Box 2.1.

Box 2.1 Description of two meta-analyses of FDI and taxation

Meta-analysis is a research method to synthesise research results and can be used as a statistical way of reviewing and summarising empirical results. It provides a tool to compare and/or combine outcomes of different empirical studies with similar setups or setups that can be controlled for. Meta-analysis has two advantages that make it useful for our purposes:

- Systematic approach to analysing the sources of variation in existing empirical studies.
- Provides the possibility of investing how research design, model specification and estimation technique impact on empirical results.

Some of the problems related to the meta-analysis are the risk of publication bias in the results, concerns about the comparability of estimated effects and the degree of independence between different empirical studies. The setup and main findings in the meta-analysis by Mooij and Ederveen (2006) and Feld and Heckemeyer (2009) are summarised in Table 2.3.

Table 2.3 Summary of findings from two meta analysis

Study	Meta-analysis setup	Main findings
Mooij and Ederveen (2006)	Covers 31 empirical papers including 427 semi- elasticities in EU countries, the US, Australia, Canada and Japan during the 1980s and 1990s	The median semi-elasticity is -2.9 where: ▪ Cross-section studies yield larger elasticities than discrete choice models ▪ Real investments in plants are more responsive to taxes than other forms of FDI ▪ FDI is more responsive to effective tax rates than statutory tax rates ▪ No significant difference between estimates for parents from tax exemption countries and estimates from tax credit countries ▪ The change in elasticities is non-linear (higher in the 1990s than in the 1980s) ▪ No systematic variation between small and large countries
Feld and Heckemeyer (2009)	Covers 45 empirical papers including 730 semi- elasticities in a broad selection of OECD countries during the period 1965-2005	The median semi-elasticity is -1.7 where: ▪ Studies using aggregate data produce higher elasticities than micro level analyses ▪ FDI is more responsive to effective rather than statutory tax rates ▪ Localisation of economic rents is less influenced by taxes than the marginal investment decision ▪ Allowing public spending to adjust to tax changes has no impact on tax elasticities ▪ Including time fixed effects reduces the significance of tax effects ▪ Agglomeration effects do not have any robust significant effect on estimated tax elasticities ▪ Tax elasticities are higher in studies including EU countries compared to the US

Source:Copenhagen Economics.

2.3.1. Learning point 3: Tax elasticities are non-linear over time

Increased international capital mobility and globalisation of production may suggest that multinational companies have become more responsive to tax changes and tax differentials over time. A study analysing the investment decisions of US multinational companies during 1984-1992 finds that the investment location choice has become more sensitive to differences in host country taxes during the 80s and early 90s.[6] Also, the meta-analysis covering 31 empirical studies finds that tax elasticities were higher in the 1990s than in the 1980s but also that the rise in the responsiveness of capital seems far from linear across time.[7] The policy implication is that calculations based on historical tax elasticities may overestimate the budgetary impacts of increasing taxes on multinational companies.

[6] See Altshuler, Grubert and Newlon (2001).
[7] See Mooij and Ederveen (2006).

2.3.2. Learning point 4: Investors respond differently to taxes across groups of countries

Due to the free movement of capital within the internal market, it is likely that companies are more responsive to taxes when they invest in the EU than in other regions. The empirical literature seems to provide supporting evidence for this. The meta-analysis covering 45 empirical studies finds that empirical studies including investments in Europe tend to find larger tax elasticities than studies including investments in other target regions.[8] Also, a study on how tax differentials influence FDI flows from old to new EU Member States during 1995-2006 concludes that large tax differences have strong impact on flow of FDI from EU15 to the new Member States whereas the impact on intra-EU15 FDI flows is insignificant.[9] A one percent increase in the tax differential leads to a reduction of FDI from EU15 to the new Member States of about four percent. The findings therefore suggest that the previous competition for FDI across old Member States has been replaced by competition from new Member States.

However, it may be the case that the tax responsiveness of investors is not uniform across EU Member States. The meta analysis covering 31 empirical studies, for example, make a distinction between peripheral and core EU countries and find a higher responsiveness of investments in peripheral countries than in core EU countries.[10] The difference can be explained by agglomeration forces, which make the core EU countries relatively more attractive. However, the impact is not statistically significant. This study also finds that there is no systematic difference in elasticities across groups of small and large countries.

2.3.3. Learning point 5: Agglomeration effects to not seem to influence tax elasticities

Forces of agglomeration – the geographic clustering of economic activity – may also affect the level of FDI and the way FDI responds to taxes. Agglomeration is often grounded in a desire to facilitate knowledge spillovers, to provide a thicker market for specialised skills, or to provide greater opportunity for the development of specialised inputs and services. In the presence of such agglomeration effects, governments can tax the capital located in these agglomerations (such as financial centres) without inducing capital flight. Many empirical studies find strong agglomeration

[8] See Feld and Heckemeyer (2009).
[9] See Hansson and Olofsdotter (2010).
[10] See Mooij and Ederveen (2006).

effects[11], but no empirical papers have analysed the presence of agglomeration forces in the financial sector. However, another study finds that agglomeration effects do not have any robust significant effect on estimated tax elasticities.[12] The implications is that governments in countries with strong financial centres should expect the same degree of capital flight as other countries if they start taxing the financial sector, and that their comparative advantage in the financial sector should not be taken for granted.

2.4. Concluding remarks

We have focused on the importance of host country taxation on the location of investments by financial companies. We find that financial companies respond to higher taxes by establishing less foreign subsidiaries and by investing less intensively in the high tax country. This is also the case in other sectors but the empirical literature summarised in this chapter suggest that the tax responsiveness of financial companies is larger than companies in other sectors.

There are a number of shortcomings in the empirical literature that should be kept in mind when using the elasticities reported in this paper for making impact assessments of changes in financial sector taxation. *First*, there are only a limited number of studies that are directly applicable in this context. *Second*, the empirical estimates of tax elasticities in the financial sector are based on relatively old data. This is a problem since empirical evidence on tax elasticities in other sectors suggests that investors may have become more sensitive to tax changes over time. *Third*, the empirical studies have so far ignored the dynamic response of investors and no distinction between short and long-term responses has been made. And, finally, the level of aggregation may be to crude since different activities carried out by financial companies may respond differently to tax changes.

As we will discuss in the next chapter, however, if there are widespread possibilities for profit-shifting (i.e. so that pre-tax profits can be reported

[11] See for example Bobonis and Shatz (2006) as well as Head and Maier (2004).
[12] See Feld and Heckemeyer (2009).

in the country where taxation is the lowest) then corporate taxation may matter less in any cases.

3. TAXES AND PROFITS IN FINANCIAL COMPANIES

In recent years, international financial markets have become increasingly integrated. However, the tax liability of financial companies remains within national tax authorities. In taxing a financial company, national tax authorities face many of the challenges and trade-offs inherent in taxing MNEs. Multinational financial companies have opportunities for reducing their tax burdens in high-tax countries by shifting reported profits towards the low tax location. One way to do this is through intra-firm transfer pricing. Also, the high level of mobility of international financial institutions may imply that taxes are relatively distortive and will largely be passed on to domestic customers or be avoided through tax planning activities. In assessing the budgetary impacts of increasing taxation of financial companies one therefore needs to take into account how taxes impact profits in financial companies. This is the main issue in this chapter.

In this chapter we are interested in the responsiveness of the tax base to a tax on financial activities - including the so-called Financial Activities Tax (cf. Box 3.1) – and we therefore summarise the theoretical and empirical findings on the relationship between taxes and profits in financial companies. In Section 3.1 we sketch out how taxes may impact profits in financial companies. In Section 3.2 we summarise the main findings in the empirical literature on the relationship between taxes and profits in financial companies. Here, we distinguish between the ability of financial companies to pass on taxes to their customers and the ability of multinational financial companies to shift profit to low tax locations. In Section 3.3 we examine the possible non-linearity of profit shifting tax elasticities. Tax elasticities may be non-linear due to different degrees of market competition, due to different sizes of the financial companies, and due to the existence of tax havens. In Section 3.4 we provide some concluding remarks.

Box 3.1 Motivations and content of different versions of a FAT

In recent time, there have been calls for a Financial Activities Tax (FAT). Two variants have been introduced, somewhat targeting different objectives.[13] The FAT1 is essentially designed as a tax on value added in the financial sector (equal to gross wage costs and gross profits). The FAT1 is seen as a "repair" mechanism for a VAT system, which, by exempting financial service from VAT, provides a net advantage for the financial sector. FAT2 is designed to extract perceived economic rents in financial services. Proposed tax bases are, for

[13] See for example Keen (2001),"Rethinking the Taxation of the Financial Sector", CESifo Economic Studies, vol 57, Devereux (2011),"New Bank Taxes: Why and what will the effects?", Oxford University Centre for Business Taxation and P.B. Sørensen (2011), "The Danish Experience with a Financial Activites Tax", Brussel Tax Forum March 2011.

example, gross income minus "normal" remuneration of staff and capital, implicitly implying additional taxes on very high profits and levels of staff remuneration.

As this study is not about optimal taxation of the financial sector, but about likely tax elasticities we will at this point just highlight two simple points. First, a FAT1 is by nature targeting the least mobile part of the broad income tax base in the financial sector, and as it involves staff costs including in the least mobile part of the banking sector, namely retail banking focused on household, small and medium sized enterprises etc. The FAT1 is dominant in most countries except small financial centres such as Luxembourg. The Danish FAT, for example, is a variant of the so-called FAT1.[14]

Second, a FAT2 is by nature targeting the most mobile part of the broad income tax base in the financial sector namely the capital and staff involved in securities trading, fund management, investment banking etc. These are the segments of the financial sector where above normal remuneration of capital and staff has motivated the FAT in the first place.

Hence, a FAT1 is likely to have lower – and a FAT2 substantially higher – elasticities with respect to reported bank profits. This is so because the FAT2 is designed to extract perceived economic rents in financial services and therefore takes on board proposed tax bases.

Source:Copenhagen Economics.

3.1. How taxes may impact profits in financial companies

A higher tax on profits in financial companies is likely to be followed by at least three kinds of behavioural responses affecting the pass-through of tax rates on profits. *First*, companies will find that a higher tax rate increases their cost of capital. If market conditions allow it, they will attempt to recoup such costs by higher lending rates etc. *Second*, targeted companies may lose market shares (for example in consumer loans) to non-target companies such as large retailers, car dealers etc. *Thirdly*, profits may be shifted to other tax jurisdictions, by shifting reported profits towards low tax locations (e.g. by engaging in more intercompany transactions at the expense of arm's length transactions).

In the next section we will summarise some of the empirical studies of how taxes impact on profits in financial companies. There are only a few studies that look at profit and income shifting behaviour in financial companies, and many broader studies directly exclude the financial

[14] Since 1988 a Danish tax on the financial sector with FAT1 characteristics has been in place. While no formal evaluation has taken place, a presentation at the Brussels Tax Forum in March 2011, suggested that the tax was unlikely to have been largely passed on to consumers since the interest rate margin does not seem to have been affected by the introduction and subsequent increase in the FAT. This is in line with the logic outlined in the main text above see P.B.Sørensen (2011).

sector.[15] To learn more about the empirical relationship between taxes and profits in financial companies, we also draw on papers that include other types of companies. However, it is important to keep in mind that (in the case of banks) the effects of corporate taxes are quite different since most financial companies are subject to specific regulation that may also influence their behaviour.[16]

3.2. Impacts of taxes on profits in financial companies

Income or profit shifting cannot be observed directly since this would require detailed information on intra-company transactions of the multinational firm. Here, we have reviewed four empirical studies that attempt to estimate such tax shifting behaviour by looking at selection of variables within the company that may be affected by such tax shifting. These papers have been summarised in Table 3.1 below and will be explained in more detail in the following sections.

Overall, available studies suggest that financial companies are able to pass on taxes to their customers. Profit before tax in the banking sector responds positively to changes in the statutory tax rate (STR) and even more so than other main components of banks' income statement, cf. Table 3.1. A one percent increase in STR increases profits before tax by 1.06 percent and net income in the banking sector by 0.09 percent. Also, we find that pre-tax profits reported by domestic and foreign-owned financial companies located in the same country respond differently to tax changes. When the STR (ATR) increases by one percent pre-tax profits as a share of total bank assets in domestic-owned financial companies will increase by 0.03 (0.04) percent. This is consistent with domestic financial companies passing on taxes to their customers. For foreign-owned companies the response is quite the opposite. When the STR or the ATR increases by one percent, pre-tax profits as a share of total bank assets in foreign-owned financial companies will drop by -0.02 percent. This underlines the importance of internationalisation of banks as a factor that affects the response to higher tax on reported bank profits.

[15] Examples are Mills and Newberry (2004) and Dwenger and Steiner (2009).
[16] See, among others, Albertazzi and Gambacorta (2006).

Table 3.1 Summary of empirical findings on profit shifting

Indicator of profit shifting	Tax rate measure	Elasticity	Semi-elasticity
Financial companies pass on taxes to their customers			
Profit before tax in the banking sector	STR	1.06	2.50
Net interest income in the banking sector	STR	0.09	0.22
Other income in the banking sector	STR	-0.41	-0.96
Operating costs	STR	0	0
Provisions	STR	0	0
Financial companies shift profits to low tax locations			
Pre-tax profit in domestic-owned banks as a share of total bank asset	STR ATR	0.03 0.04	
Pre-tax profit in foreign-owned banks as a share of total bank asset	STR ATR	-0.02 -0.02	

Note: The elasticities are based on the consolidated findings in Albertazzi and Gambacorta (2006) and Demirgüc-Kunt and Huizinga (2001).

Source:Copenhagen Economics.

Details of the two studies are provided underneath.

3.2.1. Learning point 1: Financial companies pass a large part of their tax burden to their customers

Two studies on the ability of financial companies to pass on taxes to their customers finds that banks are able to shift at least 90 percent of their corporate income tax burden, depending also on the competitive pressure they face (see Box 3.2 for more details). This happens mainly through a reduction in operating costs and provisions while tax shift on net interest income is more likely to occur for low level of the CIT rate when the cost of equity due to regulation is low. The implication in this context is that increased taxation of the financial sector is likely to make lending more costly. One possible consequence of the increased costs is therefore that more lending shifts outside the banking sector where regulation is less strict. While this may intensify competition to the benefit of EU lenders, the risk of lending money will also increase. To our knowledge no empirical studies have attempted to quantify these impacts.

One serious limitation of the study is that the tax change is not specific to the banking sector. Rather, the bank's customers will also be affected so that the ability to shift the tax burden on to its clients is also affected by the change. What we are interested in is the asymmetric case where a special tax is levied on the financial sector but the other sectors in the economy do not face new or increased taxes. Intuitively, one would expect that the ability to shift taxes would be greater in the asymmetric case.

Box 3.2 Details of the two studies on the degree of tax shifting

The paper by Albertazzi and Gambacorta (2006) investigates how bank profitability is affected by the corporate income tax (CIT). The analysis is based on aggregate data on the banking sector in the main industrialised countries (the US, the UK and the eight euro area countries: Germany, France, Italy, Spain, the Netherlands, Austria, Portugal and Belgium) for the period 1980-2003. The paper makes two main contributions to the empirical literature. *First*, it takes into account that the CIT is not only levied on the banking sector so that changes in the tax rate may affect both the banks and their customers (borrowing firms). *Second*, the paper considers all main components of banks' profit and loss accounts: net interest income, interest expenses, non-interest income, operating costs, and provisions. This split allows the authors to disentangle the extent to which a bank is able to shift its tax burden forward to its lenders, depositors, and purchasers of fee-generating services.

The empirical analysis includes a number of control variables (GDP, inflation, money market rate, long term government bond interest rate, stock market capitalisation, total amount of bank loans, stock market volatility and total assets in the entire banking sector). The applied estimator is Generalised Methods of Moments (GMM) where lagged values of the dependent variable have been included to take into account that banks may not respond to tax changes overnight.

The paper finds that banks are able to shift at least 90 percent of their CIT burden but that the degree of tax shifting depends on the competitive pressure in the banking sector. Tax shifting mainly takes place through a reduction in operating costs and provisions and, though not for very high levels of the CIT rate, an increase of the net interest income. The authors also find that for sufficiently competitive banking sectors, tax shifting on net interest income takes place mainly through a rise in the interest rate on loans. To test the robustness of the results, the authors test for non-linearities by testing if tax elasticities are different in the sample period (1981-1992) compared to the period (1993-2003). This does not appear to be the case. Likewise, the authors test if the tax elasticities differ between the euro area and the Anglo-Saxon countries. This does not seem to be the case.

The paper by Huizinga, Voget and Wagner (2011) examines empirically the impact of international taxation on bank interest margins and pre-tax profitability in a sample of 39 countries, of which nine are non-European countries. For the sample restricted to EU banks, the study finds a full pass-through of international taxation into higher interest margins. For EU banks, non-resident dividend withholding taxation and parent company corporate income taxation are both found to be compounded into higher interest margins. The findings imply that banks are able to pass a share of 0.90 on to bank customers and other capita providers through higher net interest income.

Source:Copenhagen Economics.

3.2.2. Learning point 2: Multinational financial companies are able to shift profits to low tax locations

Multinational financial companies have the opportunity to shift profits and income between branches in order to reduce the overall tax burden of the company. A study covering financial firms in 80 countries in the period 1988-1995, suggests that such income shifting can be substantial: Controlling for a number of other determining factors (see Box 3.3) the study finds that the profits of multinational banks with a local subsidiary reports lower than expected profits if tax rates in the country of the subsidiary are higher than the international average.

Box 3.3 Details of the study by Demirgüc-Kunt and Huizinga (2001)

Demirgüc-Kunt and Huizinga (2001) distinguish between home owned (national) and foreign owned (multinational) banks. Using a sample of 80 countries, the study finds significant differences in the pre-tax profitability as well as in the tax payments of national and multinational banks across countries. In their study, they analyse if there is a systematic relationship between the observed differences in profitability and tax rates across countries, and if this is the case, if this is consistent with income shifting. To do so, they estimate the pre-tax profitability of a bank in a specific country as a function of bank and country specific characteristics. While country characteristics control for heterogeneity across countries concerning the overall profitability of business, bank characteristics control for heterogeneity across banks and include information on whether the bank is national or multinational.

Estimation results indicate that bank characteristics (equity, loan, non-interest earning assets, and customer and short term funding) and macro indicators (GDP per capita, growth, inflation and real interest rates) are important in determining profitability. To account for taxes, the study employs statutory tax rates as well as a measure on the banks' average tax rate implicitly calculated from the balance sheet of the bank. For both these measures, estimation results show significantly positive coefficients implying that banking in high tax countries have larger pre-tax profits than banks in low tax countries. The authors interpret this as evidence that the tax burden of banks is to some extend passed on to bank customers. However, when distinguishing between national and multinational banks, estimation results do change: Interacting the tax rate variable with a dummy indicates whether the bank is national or multinational, we get the result that the pre-tax profitability of multinational banks instead is negatively correlated with the tax rate. This negative correlation is consistent with income shifting.

Having information on the tax payments of banks, the authors do also provide estimates on how these are affected by tax rates. It is found that increasing the statutory tax rate enlarges tax revenue collected from national banks. In the case of multinational banks, however, although in general these pay higher taxes than national banks, increasing statutory taxation will unambiguously reduce tax revenue collected.

Source:Copenhagen Economics.

A study comprising profits of 14,377 banks during the period 2001 to 2009 finds that the corporate income tax rate exerts a large, robust and significantly negative effect on taxable profits. The semi-elasticity lies between -5.98 and -8.51 implying that a 1%-point higher tax rate reduces reported fiscal profits by between 6 and 8.5 percent (see Box 3.4).

Box 3.4 Details of the study by IMF (2011)

IMF (2011) use Bankscope data of Bureau van Dijk, containing balance sheet and income statements for banks across the globe on the basis of annual reports. The study focuses on commercial banks, saving banks and cooperative banks and excludes other financial institutions (such as investment banks, holding companies or mortgage banks). The study also eliminates inactive banks from the sample and zooms in on unconsolidated accounts. 82 countries in Europe, Asia and the Americas were selected containing data for 14,377 banks (excluding banks with negative equity value or a negative capital ratio) during the period 2001 to 2009.

Two dependent variables have been used. First, the authors divide total tax payments by the statutory corporate income tax rate of the country to obtain gross fiscal profit. This is expressed in terms of either employment or total assets. Second, they consider reported profits as a share of total assets. The study finds that the semi-elasticity lies between -5.98 and -8.51.

Source:Copenhagen Economics.

3.3. The non-linearity of tax elasticities

The findings in a number of empirical studies suggest that tax elasticities are unlikely to be homogeneous over markets and over time, cf. Table 3.2. More details of the conclusions can be found underneath.

Table 3.2 Summary of papers on the non-linearity of tax elasticities

Study	Methodology	Finding
Albertazzi and Gambacorta (2006)	Dynamic GMM on panel data from the banking sector in the main industrialised countries during 1980-2003	High profit shifting activity in the banking sector in response to a tax increase. The median semi-elasticity of profit before with respect to the tax is -2.5. Also: • Finds a non-linear relation ship between STR and net interest income • For lower level of STR banks tend to shift the tax burden to the lenders than depositors
Mintz and Smart (2003)	Difference in difference (DID) regression using six Canadian provinces in the time period 1986-1999	The median semi-elasticity of large subsidiaries with respect to the STR tax is -8.5 where: • Multi-jurisdictional firms operating through subsidiaries show income shifting behaviour to avoid substantial amounts of corporate taxes in Canada • Firms with large subsidiaries have higher elasticity of tax rates compare to firms with out subsidiaries (small firms)
Overesch and Wamster (2009)	Count data regression (non-linear Poison regression) on German outbound FDI in 30 EU countries during 1989 to 2005	The elasticity of number of subsidiary with respect to the STR is -1.826 where: • Asymmetric tax elasticity across different business activities where the strongest effect has been found in financial services and R and D activities as they have highly mobile profits • An increasing internationalisation is associated with decreasing tax elasticities
Grubert and Slemrod (1998)	Tobit and Probit regression model (non-linear model) using a micro data on US subsidiaries in Puerto Rico during 1987	High income shifting advantages of US multinationals in Puerto Rico where taxes are lower. The study finds that tax elasticities are asymmetric due to different tax rate across countries (tax havens)

Source:Copenhagen Economics.

3.3.1. Learning point 3: There are asymmetries related to the degree of market competition

The tax elasticity may not be linear because the possibility for a bank to shift part of the tax burden to its customers is likely to depend on the competitiveness of the market in which it operates.[17] One implication is that a solid empirical investigation of this issue should take into account the great changes due to the effect of deregulation of the financial sector over time. Another implication is the elasticity cannot be expected to be the same over the business cycle.[18]

3.3.2. Learning point 4: There are asymmetries related to the size of the financial company

The degree of internationalisation of the multinational company may also cause tax asymmetries. On the one hand, opportunities for income shifting will decrease the effective tax rate a firm has to pay in a particular country. On the other hand, to make use of income shifting strategies, a

[17] See Albertazzi and Gambacorta (2006).
[18] See also the non-empirical study by Creedy and Gemmell (2008).

multinational enterprise needs an affiliate in a low tax country to which income can be shifted. Underneath we will discuss some of the studies, which deal with this issue. One implication is that the profit-shifting decision discussed in this chapter cannot be fully separated from the location decision discussed in Chapter 2.

A study of Canadian firms distinguishes between large firms which may engage in income shifting (operate in multiple jurisdictions), large firms where income shifting is not possible (operate in a single jurisdiction) and small firms which can not make use of income shifting strategies at all.[19] This distinction allows the authors to test both for national and international income shifting. While the effect of taxes is insignificant for small firms, the effect for large firms that may engage in income shifting is about two times larger than for those firms, which are not able to shift income. The evidence suggests that income shifting has pronounced effects on provincial tax bases. According to their preferred estimate, the elasticity of taxable income with respect to tax rates for "income shifting" firms is 4.9, compared with 2.3 for other, comparable firms. They interpret the observed dissimilarities to represent differences in real mobility as well as in mobility of income: While small firms are immobile across provinces, the observed effect for large non-shifting firms represents their opportunity to locate real economic activity in low tax provinces. The somewhat larger effect for shifting firms represents both, their opportunity to locate real activity in low tax provinces and their opportunities to shift income. So, the result that these firms, which are able to shift income, do reply more heavily to tax rates is taken as evidence for income shifting.

Another study shows that US multinationals with higher-than-average activities in R&D or advertising choose locations with extreme tax levels. Income derived from R&D based intangibles accounts for about half of the income shifted from high-tax to low-tax countries.[20] R&D intensive subsidiaries engage in a greater volume of intercompany transactions and, therefore, have more opportunities for income shifting. In addition, subsidiaries in locations with either very high or very low statutory tax rates, with a strong incentive to shift income in or out, also undertake a significantly larger volume of intercompany transactions. Finally, R&D intensive US parent companies respond to the opportunities for income

[19] See Mintz and Smart (2003).
[20] See the non-empirical study by Grubert (2003).

shifting by investing in countries with either very high or very low statutory tax rates.

The results from a study on the number of German outbound FDI in 30 EU countries across all sectors suggest that tax elasticities depend on the multinationals' opportunities to shift profits.[21] If the multinationals are able to shift profits, local tax rates may be less relevant because effective tax payments are small or even zero. The opportunity to shift profits, however, is only available to firms with affiliates at several locations. Hence, tax effects can be expected to be higher for the location decisions of single-subsidiary multinationals compared to multi-subsidiary multinationals, because the latter are able to shift profits. The study finds that the elasticity with respect to the effective average tax rate of German multinationals is -5.68 for companies with multiple foreign subsidiaries and -2.20 for companies with a single foreign subsidiary.

Our reading of these studies suggests that financial services which tend to be one of the most globally oriented business with top layer firms in all developed countries having substantial investments in many tax jurisdictions and with high inherent mobility of assets may indeed be an industry with tax induced mobility.

3.4. Concluding remarks

The empirical findings suggest that an increase in the tax rate leads to an increase in profit before taxes, which shows that national banks can shift at least part of the tax burden on to their customers.[22] The way banks do this in practice is to shift towards buyers of fee-generating services for high tax rate levels. Multinational banks also have the opportunity to shift profits towards low tax locations and thereby reduce their tax burden. One implication is that a financial activities tax will mainly be borne by customers in the financial sector and by small financial companies who do not have the opportunity to shift profits across borders. While taxing rents could reduce the shift of tax burden to consumers such a tax could be prone to profit shifting if the tax rate is relatively high in comparison to other countries.

[21] See Overesch and Wamster (2009).
[22] See Demirgüç-Kunt and Huizinga (2001) and Albertazzi and Gambacorta (2006).

4. TAXES AND TRANSACTIONS IN FINANCIAL MARKETS

A financial transaction is a broad definition that covers several issues. In its broadest sense, a financial transaction is any payment of money (cash or transfer) between a buyer and a seller attached to the (contractual) transfer of an asset. The transferred asset can be a non-financial good or service as well as financial assets and instruments like equities, bonds, derivative contracts or currencies.

Transactions are at the heart of any market. For a market to function efficiently (or even exist) transactions need to take place. This is also the case for financial markets. A financial transaction will generally take place when the benefit to the market actors exceeds the cost of the transaction. There are both direct pecuniary benefits associated with a transaction in terms of a return but there are also indirect benefits from e.g. better protection against risk or improved liquidity management. Costs associated with a transaction are normally imposed by fees, taxes or premiums to intermediary traders.

In recent time there have been calls for a tax on financial transactions.[23] If properly enforced, such a tax will effectively raise the costs of conducting a transaction. When evaluating the effectiveness of such a tax and its revenue potential, the response of the tax base is of crucial importance. If a tax causes large incentive shift for market agents the tax base might be reduced considerably.

In this chapter we are interested in analysing the responsiveness of the tax base to a tax on financial transactions. More specifically we will study the tax elasticity associated with the volume of financial transactions. In Section 4.1 we sketch out why taxes may impact financial transactions. We describe features of financial transactions, summarise existing transaction taxes and discuss general design issues with respect to possible substitution alternatives. In Section 4.2 we summarise the main findings in the empirical and theoretical literature into a number of learning points.

[23] See e.g. the French priorities for their G20 presidency and European Parliament resolution of 10 March 2010 on financial transaction taxes.

4.1. How taxes may impact transactions in financial companies

Taxing financial transactions is not a new idea. Proponents of such a tax have argued for this mainly for two purposes. *First*, a tax can generate large revenues due to the large amount of financial transactions conducted. *Second*, a tax can stabilise financial markets by reducing the amount of short-term trading. These two arguments seem to go in opposite directions: if the tax succeeds in reducing the amount of transactions the revenue potential will be reduced.

The first recorded argument for a financial transaction tax seems to go back to Keynes (1936) who argued that a transaction tax might be useful to mitigate speculative activities. Tobin (1978) argued for a transaction tax specifically on foreign exchange transactions as a means to regulate capital flows. The use of transaction taxes as a second-best alternative to well designed financial regulation has also been proposed.[24] More recent proponents of a transaction tax have been focusing more on the revenue raising possibilities of a transaction tax due to the large potential tax base.[25]

A financial transaction tax has the potential nice property of being levied on a relatively broad tax base and can thus *potentially* generate significant revenue for even very small tax rates – under the important condition that the tax base is relatively stable.

In an efficient market almost any tax will distort optimal market behaviour and will lead to efficiency losses. In tax theory, a general principle is that the less effect a tax will have on behavioural decisions the less distortive it will be. Since a financial transaction tax affects choices in the production decisions it will, by this argument, be more distortive than e.g. a tax on profits or value-added. Moreover, a transaction tax might cascade through the production process thus burdening (arbitrarily) some sectors of the economy harder than others. In particular it will to a larger extent affect smaller firms that need to buy financial risk hedging products in the market as opposed to larger firms that can carry out financial hedging within the firm. A thorough discussion about potential distortions of a financial transaction tax is, however, beyond the scope of this report.

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[24] See e.g. Stiglitz (1989) and Summers & Summers (1989).
[25] See e.g. Schulmeister et al. (2008) and Schmidt (2007).

As mentioned in the introduction, a stable tax base is crucial for the revenue potential of a specific tax. Even though the volume of financial transactions is large, there are also readily available financial products to be substituted amongst in order to obtain a similar economic outcome. The more alternative products for substitution, the higher the risk is that the tax base will deteriorate. This places high demands on the design of a financial transaction tax. As an example of how flexible a tax base can be, consider Sweden in the mid-late 1980s. Here a 0.005-0.015 percent tax on transactions of fixed income securities and their derivatives lead to a reduction in the transaction volume of 85 percent. Moreover, a two percent tax on equity trading lead to a reduction of 60 percent in the trading volume of the 11 most actively traded Swedish shares. The trading simply migrated to London.[26]

4.1.1. Existing taxes on financial transactions

In this paper a financial transaction tax is a broad measure of different types of transaction taxes. In the literature different types of transactions taxes are defined by other names. For example, a *Securities transaction tax (STT)* is a tax that is levied on the gross transaction volume of equity securities, debt securities and related derivate products including options, swaps, futures and forwards traded in exchanges and over-the-counter (OTC) respectively. Moreover, a *Currency transaction tax (CTT)* is a tax that is levied on the gross transaction volume of foreign exchange transactions in spot markets as well as in future and derivatives markets involving currency transactions. Other types of taxes are also used, cf. Figure 4.1.

Several countries have experimented with taxes on financial transactions and several countries have also removed these taxes again. Still a number of taxes are in effect today.[27]

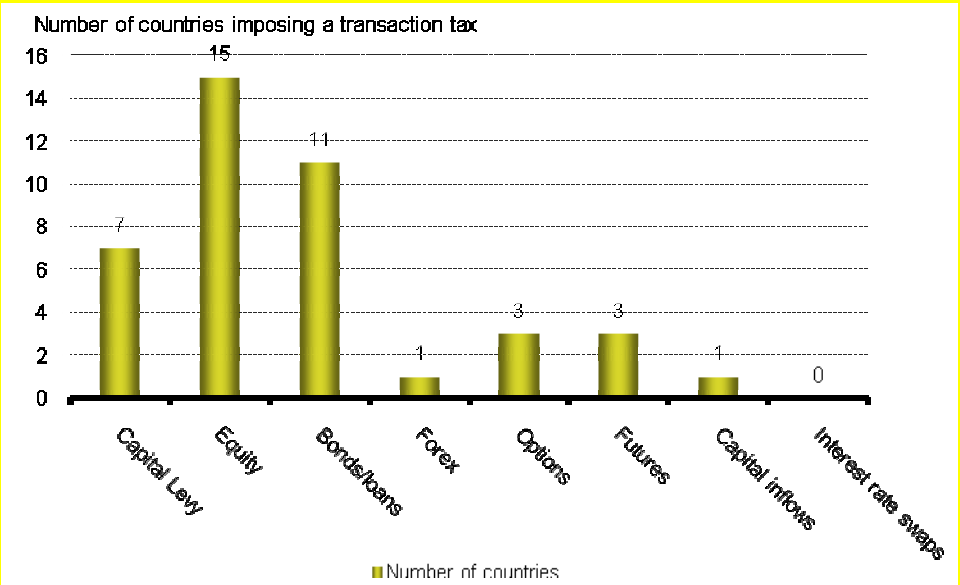
The most common transaction tax among G20 members is a tax on transactions in equity and bonds (an STT). On the contrary only a few countries (the UK, India and Taiwan) impose taxes on derivative transactions such as options and futures, cf. Figure 4.1. Moreover, Brazil

[26] See e.g. Umlauf (1993) and Campbell & Froot (1994).

[27] See Table 4.5 in Appendix for a full overview of taxes in G20 countries and major non-G20 financial centres.

is the only country in our sample that levies a tax on foreign exchange transactions and capital inflows. So far no country has implemented a tax on interest rate swaps. These products are likely very responsive even small taxes (we discuss this in detail in the following sections). Even though the amount of these transactions is large (and growing) its potential as a reliable tax base is limited.

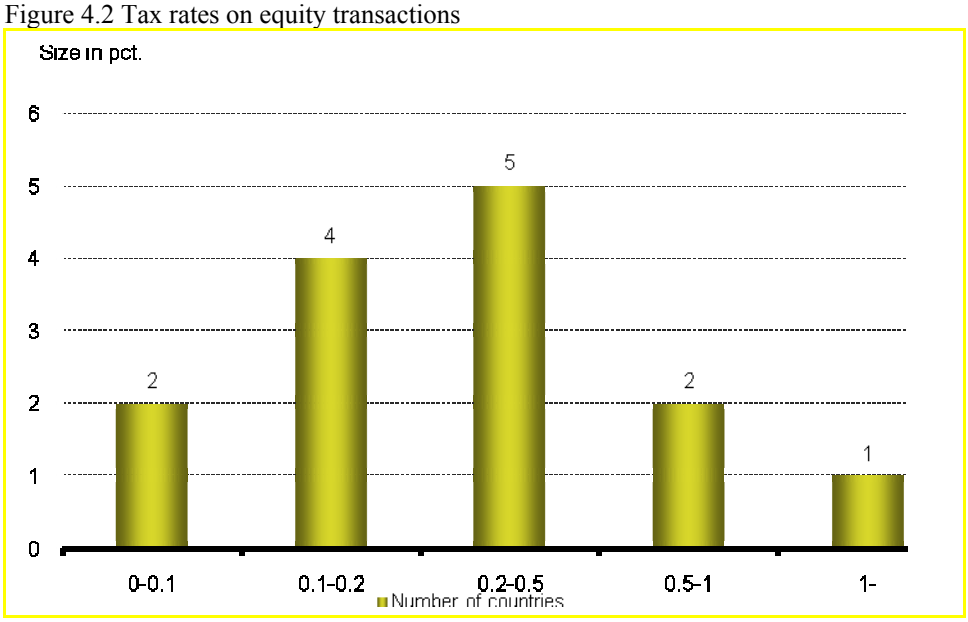
Figure 4.1 Transaction taxes in selected countries by financial product



Note: Our sample includes G20 countries and Hong Kong, Singapore, Switzerland, Taiwan and Chile. See Table 4.5 in Appendix for a full overview of transaction taxes in place in the selected countries.
Source:Copenhagen Economics based on Matheson (2011).

The size of the taxes levied varies across countries. Tax rates on equity transactions are mostly levied in the range of 0.1-0.5 percent, cf. Figure 4.2. Few countries (Brazil, the UK and South Korea) impose a tax rate of 0.5 and above.

Figure 4.2 Tax rates on equity transactions



Note: 0-0.1: Italy, and the US, 0.1-0.2: China, Hong Kong, Indonesia and Turkey, 0.2-0.5: India, Singapore, South Africa, Switzerland and Taiwan, 0.5-1: South Korea and the UK, and 1-: Brazil.
Source:Copenhagen Economics based on Matheson (2011).

Two of the more prominent examples in the literature are the experiment in Sweden from 1984-1991 and the more permanent stamp duty in the UK. Table 4.1 highlights some of the features of these two cases. In the case of Sweden, several transaction taxes were imposed in the time period on equity spot trading and fixed income securities (both spot and derivatives). The stamp duty in the UK is only imposed on equity spot trading. The main difference in the observed market behaviour however can be explained by the difference in the exemption possibilities included in the tax. In short; Sweden taxed the use of Swedish brokers on both domestic and foreign stocks while the UK taxed only domestic stocks that were also traded abroad.

Table 4.1 Comparing the experience of Sweden and the UK

Feature	Swedish case*	UK case**
Period	1984 – 1991	1986 (in modern form) – present
Rate/Base	0.5-1.0 pct / equity spot trading 0.002-0.015 pct / fixed income securities and their derivatives	0.5 pct / equity spot trading (shift of property right)
Other features/exemptions	No tax on OTC trading Tax only applicable to Swedish registered securities	Intermediary transactions exempt
Substitution alternatives	Foreign investors could use non-Swedish brokers for trades in Swedish securities Foreign investors evaded Swedish brokers when trading in Sweden or traded Swedish securities in London or New York	Equity spot trading migrated to equity derivatives – no change of property right No geographic distortion since the UK equity taxed abroad

Source: Campbell and Froot (1994), ** Matheson (2011).*

The Swedish case also highlights some interesting issues with respect to the responsiveness of the tax base. *One example is*, the traded volume of fixed income securities (e.g. corporate and sovereign bonds) and their derivatives decreased massively in response to the relatively small tax ranging between 0.002-0.015 percent. Estimates suggest that the volume of bonds and bond futures decreased by 80 and 98 percent respectively.[28] This is explained in the literature by a massive shift from futures traded on exchanges to OTC forward contracts that were exempt from the tax. *Another examples is*, the volume of equity transactions by foreign investors did not seem to change in response to the rather large tax increase of 0.5-1 percent on equity transactions. This can primarily be explained by the fact that foreign investors were able to evade the tax e.g. by moving the trades of Swedish equity to exchanges overseas.[29] The example also shows that even though the volume of equity transactions did not decline by much, the tax base still deteriorated.

4.1.2. Designing a financial transaction tax

To secure stable revenue of a transaction tax it is important to levy the tax on a large and inelastic tax base. The size of the potential tax base is not clear-cut. Several revenue estimates in the literature assume that a tax should be based on the notional value of a transaction. This may be appropriate for some financial transactions but may be just as inappropriate for other transaction types. We will discuss this below.

[28] See Campbell and Froot (1994).
[29] See Campbell and Froot (1994).

Even if it should be possible to design a large tax base, the base will normally be very flexible due to the sheer amount of alternative investment possibilities that can be used to generate a similar economic result.

Some products have more substitution possibilities than others. At the one extreme are risk neutral traders seeking rent. In this case only the potential profit and not the specific type of transaction is important. These types of transactions are very elastic. At the other extreme are e.g. products that are important as a production input or for consumption. Such transactions tend to be less elastic since there will be created value in addition to pecuniary rent. These extreme relationships are confirmed by empirical studies, which find that the tax elasticity of e.g. equity futures is significantly larger than agriculture futures.[30]

For a tax to distort the tax base as little as possible it should be imposed on potential substitution alternatives as well as the originally intended tax base. In Table 4.2 we present a number of possible substitution alternatives to specific financial products and suggest how a potential tax should be designed to counter the substitution alternative.

Table 4.2 Potential substitution alternatives to different tax bases

Substitution alternative	Potential tax
Risk and liquidity management can be conducted using different financial products (e.g. interest rate swaps, fixed income derivatives, commodities such as gold etc.)	Financial products with similar economic effect should be taxed similarly
Substitute from exchange based trade to OTC trade	OTC trade should be taxed similarly to exchange based trade
Substitute from spot trade to derivatives trade	Derivatives trade should be taxed similarly to the spot trading of the underlying security
Substitute from domestic based trading to trading abroad	The tax should be enforced multilaterally
Substitute from trading of domestic securities to foreign securities	A tax on domestic securities should be imposed multilaterally
Equity based corporate financing to debt based corporate financing and vice versa	Both issuance of corporate equity and debt should be taxed

Source:Copenhagen Economics.

Economic incentives suggest that innovative ideas will be developed to avoid increased taxation in general. This is also the case in the financial sector where the possibility of structuring financial products with

[30]See Wang et al. (1997) or Wang and Yau (2000) that find elasticity of agriculture future and equity futures to be 0.1 and 0.7-2.0 respectively.

basically the same economic properties is relatively large. This suggests that even taxes that have been well designed with respect to keeping a stable tax base might eventually erode the same tax base once new substitution alternatives have been developed.

4.1.3. Choosing the right tax base

Defining the value of a financial transaction and hence the appropriate tax base is not straight-forward. This is because that the notional value of financial transactions is not necessarily equal to the value derived from making the transaction. While the value of a stock transaction is the price paid for the stock (notional value), the value of derivatives such as futures and swaps are much less clear. These products are to a large extent used to hedge against risks (e.g. against currency depreciation) or manage liquidity. The value of such transactions is significantly lower than the underlying value of the value being swapped and is therefore a poor measure for the tax base. This spurs the discussion of what would be the right base to choose when imposing a transaction tax on a derivative transaction. Only a few countries have experience with taxation of derivatives and no countries have tried taxing interest rate swaps cf. Figure 4.1 above. We will elaborate on the appropriate tax base for options, futures and interest rate swaps in the following.

For *options* there are basically three taxable parameters 1) the spot price or notional value of the underlying security, 2) the strike price at which the option may be executed and 3) the premium of the option which corresponds to the initial market value of the option. A combination of these parameters can also be used in a tax. It has e.g. been argued that *the strike* price of an option should be taxed [31] which e.g. is the case in the UK if the option is executed. Taxing the strike price may however be inconsistent with incentive and pricing structure of the market. If two options are based on the same underlying security but have different strike prices, the high-strike price-option does not involve a larger transfer of value since the likelihood is lower that such an option will be executed. [32] Option transactions could also be taxed based on the *notional value* (depending on the spot price of the underlying security). It has been argued that option transactions should be taxed based on the *premium* paid to acquire the option ownership.[33] The premium is the market price of holding the option and will therefore incorporate an evaluation of the

[31] See e.g. Stiglitz (1989).
[32] See e.g. Pollin et al. (2003).
[33] See e.g. Pollin et al. (2003).

difference between the strike and the spot price, the price history of the underlying asset etc. This is the case in Taiwan, while India imposes both a tax on the premium and on the strike price if the option is executed.

For a transaction of *futures* there is not paid a premium. Instead transactions can be taxed based on e.g. spot or delivery price. The UK and India, for example, e.g. levy a stamp duty on equity futures, which are taxed based on their delivery price.[34] On the other hand, Japan used to tax (before 1999) future transactions based on the notional value of the underlying security. It has been argued that this approach is favourable since the tax rate is being set in proportion to the actual value of the asset being traded. Other options are however also conceivable:[35] Firstly, one could imagine a tax on the margin deposits that traders make with brokers since this is the only exchange that take place initially and until the underlying asset is transferred. This will however create an incentive to minimize margins, which represents some source of protection against traders' default risk. Secondly, a tax could be flat-rate pr. transaction (as was exercised in France and Hong Kong). This puts a larger relative burden on smaller sized transactions and thereby encourages larger sized contracts.

For *interest rate swaps* it has been argued that a transaction tax should be based on the underlying assets of the transaction since the swap corresponds to a transfer of ownership of the assets.[36] However, as an example consider two agents deciding to exchange interest flows. This could e.g. be with large private firms as state debt agencies often do. Governments typically benefit from a huge liquidity premium when issuing long-term debt and hence, even when adjusted for differences in default risks, it may face lower borrowing costs than private firms. The government may however want to keep duration of their debt at lower levels. The government then receives a premium when issuing debt with long duration while taking over the interest payments of the private firm with a shorter duration. The private firm issue short-term debt while overtaking the interest payments of the government. The overall conditions of the contract are then determined by expected average differences in short and long-term rates over the duration of the contract, counterparty risks etc. But as this is simply an exchange of payment

[34] See e.g Matheson (2011).
[35] See Pollin et al. (2003) for a discussion. It argues that a tax on the notional value of future transactions is favorable.
[36] See Pollin et al. (2003) and Matheson (2011).

flows, it is very difficult to establish an economic value apart perhaps from the fees and administrative costs associated with concluding the swap.

Moreover, regarding *interest rate swaps*, the benefits of conducting interest swaps are determined by the difference between the spread of the long term rate and the spread of the short term rate. By issuing long term debt and swapping for short term interest payments, most governments most of the time (not all governments and not all the time) will be able to reduce interest rate costs for a given duration of the government debt. The difference between the two spreads is in most circumstances very small (0-30 basis points, and can also be negative). Even very small taxes on interest swap transactions (especially if the tax is levied on the underlying value of the debt) will therefore make a very large amount of these swaps unprofitable and therefore erode the tax base.

4.1.4. Revenue potential based on choice of tax base

The choice of the tax base of a transaction tax will significantly affect to potential revenue obtainable from such a tax. This can be seen in the literature where different studies suggest different revenue estimates depending on their choice of tax base. As discussed above, especially the tax base of derivatives is complicated. While taxing the notional value of equity spot trading is an appropriate measure of the value of the contract, this will not be the case for an option or an interest rate swap. Some studies in the literature finds very large revenue potentials by assuming that transaction taxes will be levied on the notional value of all instruments.[37] This will overestimate the revenue potential of a tax levied on options based on their premiums, which might be the more appropriate base.

4.1.5. Estimated semi-elasticities

Semi-elasticities are an informative tool to measure the sensitivity of the tax base in response to a tax on transactions. Some semi-elasticities can be derived from the empirical estimates of tax elasticities and some can be derived from descriptive statistics on past experiences with transaction taxes.

[37] See e.g. Schulmeister (2008).

Semi-elasticities have the nice property of depicting the change in volume as a response to change in the tax rate in percentage points. As an example the Swedish tax on equity transactions of 2 percent resulted in a reduction in trading volume of 60 percent of the 11 most traded stocks. This corresponds to a semi-elasticity of 30.

The response of different financial products varies as a response to taxation, which is reflected in this size of the semi-elasticities. As a response to a tax increase of 1 basis point (0.01 percent) estimated semi-elasticities vary from a range of 0.5-4 on equity transactions to a whopping 28-85 on fixed income securities. The large estimates of fixed income securities are derived from the Swedish case where a tax of 1-3 basis points on these securities resulted in a reduction in transaction volume of 85 percent.

Table 4.3 Semi elasticities of different financial products

Financial product	Range of semi-elasticities
Equity (spot)	0.3-4
Equity (future)	20.8
Foreign exchange	28
Fixed income securities (bonds)	28-85

Note: The semi- elasticities are measured against a tax increase of 1 basis point (0.01 pct.).

Source: Copenhagen Economics based on Baltagi et al. (2006), Liu (2007), Campbell & Froot (1994), Umlauf (1993), Chou & Wang (2006) and Schmidt (2007).

4.2. Impacts of taxes on transactions in financial companies

In this section we will present some learning points that can be derived from both the empirical and theoretical literature regarding the impact of financial transaction taxes on the volume of transactions.

4.2.1. Learning point 1: Tax should be levied on products with few substitution alternatives

If there are obvious substitution alternatives to the financial product being taxed, the tax base will be very elastic. Some of these substitution alternatives are discussed in Table 4.2. As an example, if a developed OTC-market for a financial product exists, a tax on exchange based trading of the same product will give an incentive to shift from exchange based trading towards OTC trading. The Swedish example summarised in Table 4.1 showed that the volume of bond futures transactions decreased by 98 percent in response to a relatively small tax of about 0.002-0.015 percent. Several authors suggest that this was primarily explained by a

large increase in the use of OTC based forward contracts, which has essentially the same economic characteristics as futures.

An obvious solution to this problem is to levy the tax on OTC trading as well as exchange based trading. However, OTC transactions are inherently more difficult to administer – as opposed to exchange based trading - since it relies on institutions self-reporting and not regularly updated statements from exchange houses.

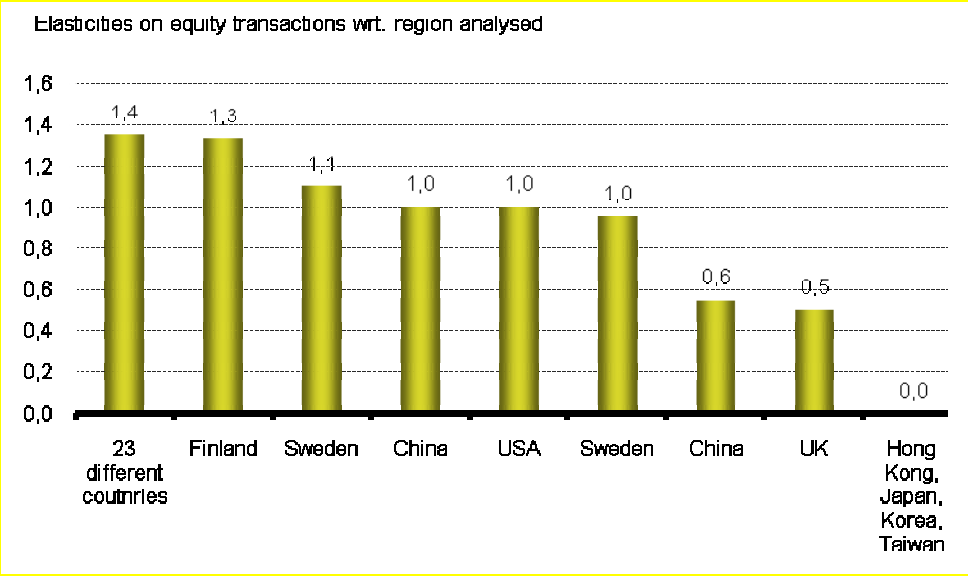
Hence, the tax effects are highly dependent on present regulatory reform efforts that specifically focus on bringing OTC products to regulated exchanges. However, just as importantly, one could argue that the efforts to push OTC products to regulated exchanges could be undermined if OTC based trading is effectively taxed at lower rates.

4.2.2. Learning point 2: Elasticity estimates may be very region-specific and should be extrapolated with caution

Elasticities can be very sensitive to the specific region and market analysed. The results in the literature should therefore be applied with caution and due respect of specific characteristics of the market (such as national regulation).

As an example, one of the lowest estimates of the elasticity of equity transactions in the literature is found analysing equity spot trading in China from 1991-2008, cf. Figure 4.3. This may be explained by the heavy regulation of financial trading in China, and we would expect the elasticity in other more liberalised regions such as the EU to be of a greater magnitude since the alternative possibilities for substituting to different products is higher.

Figure 4.3 Equity spot elasticities by region analysed



Note: The studies used are described in Table 0.4. The estimate for UK is derived from Jackson & O'Donnel (1984) cited by Matheson (2011).

Source: Copenhagen Economics.

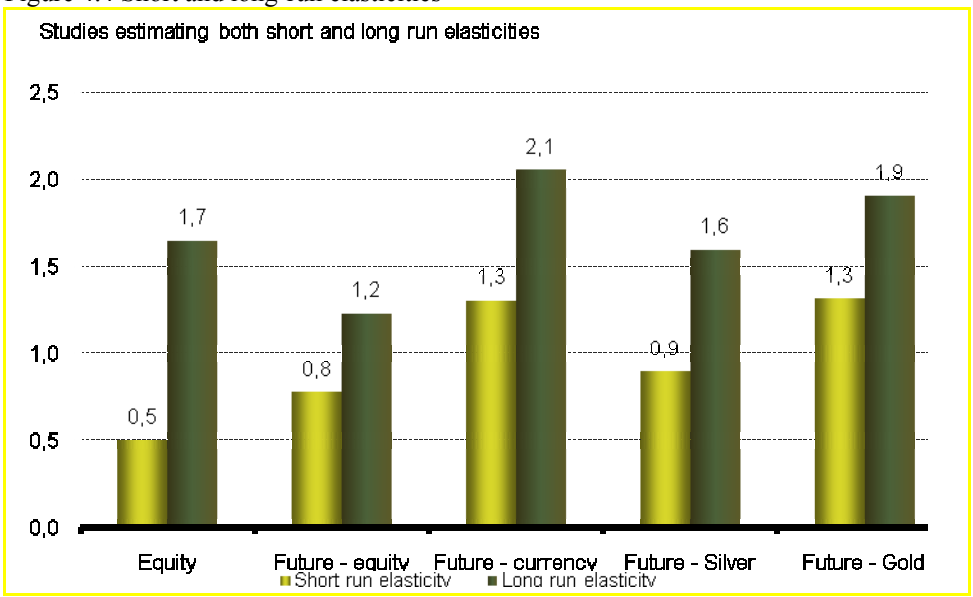
However, we would expect the elasticity to be lower in countries that host financial centres compared to other countries. There might be agglomeration effects of trading in a large stock exchange thus making it less attractive to shift the stock supply in response to a tax increase to a smaller stock exchange with smaller liquidity and demand potential. The available empirical evidence for this is not convincing but may be able to explain the relatively high elasticities estimated in Sweden and Finland and the large adverse reaction of the Swedish financial market observed in response to the introduction of different taxes on financial transactions around the 1990s. The low estimated elasticity on equity spot transactions in the UK might on the other hand be explained by the fact that the stamp duty in the UK grants a legal security with regard to the transfer of ownership. This makes the tax difficult to avoid in an investor indeed wants to own a UK-registered company. Transactions in the UK where transfer of ownership is not an issue we would expect a much larger elasticity.

4.2.3. Learning point 3: Long-run elasticities seem larger than short-run elasticities

Over time there will be a larger reduction in volume turnover than the immediate response. In fact, Figure 4.4 shows that long-run elasticities tend to be greater than short-run elasticities. According to the available empirical literature this holds true for different financial products e.g.

equity spot transactions and future transaction of equity, foreign exchange and metal commodities respectively.

Figure 4.4 Short and long-run elasticities



Note: The studies used are described in Table 0.4. The estimate for equity spot is derived from Jackson & O'Donnel (1984) cited by Matheson (2011).

Source: Copenhagen Economics.

This suggests that if revenue estimates only consider studies that evaluate the immediate effect of a tax on volume turnover there might be an even larger deterioration of the tax base over time. We would expect the difference between short and long-run elasticities to be the higher in a liberalised financial market with few *obvious* substitution alternatives to a specific financial product. Over time the market may then develop such alternatives and the tax base will deteriorate further. This is in contrast to a market with obvious substitution alternatives where we would expect a high short run elasticity to internalise the immediate response.

4.2.4. Learning point 4: Foreign exchange transactions seem less elastic than equity transactions

From Table 4.4 it can be seen that the range of estimates of elasticities with respect to equity transactions are lower than the range of estimates with respect to foreign exchange trading. This indicates that the volume of equity transactions will decrease more rapidly as a response to a transaction tax than the foreign exchange transaction volume.

Table 4.4 Elasticity estimates on spot and future trading of equity and Forex

Financial product	Elasticity - Spot market	Average	Elasticity – Futures market	Average
Equity	0-1.65	(0.9)	0.6-2.0	(1.1)
Foreign exchange	0.3-0.79	(0.5)	0.5-2.7	(1.7)

Note: The studies used are described in Table 4.5Appendix Table 0.4 and Table 0.5.
Source: Copenhagen Economics.

A possible explanation for this is that the alternative substitution options for a foreign exchange transaction are not as widespread as that for equity transactions. A stock of foreign exchange is beneficial primarily as a means to make real investments in a foreign country and hedge against currency risk. In equilibrium, some real investments may be deterred by a modest currency transaction tax, but we would not expect this to cause a large shift in real investments from a country with a currency transaction tax to a non-taxed country.

This would suggest that a tax on foreign exchange transactions would give rise to a smaller reduction in transactions volume than a tax on equity transactions. A currency transaction tax would, however, involve some enforcement challenges.

4.2.5. Learning point 5: Elasticity of futures (on foreign exchange) is larger than elasticity of spot trading

Table 4.4 also shows that the literature analysing foreign exchange future contracts generally find a larger elasticity than the spot price contracts. Foreign exchange transactions can be used in relation to both real activity and to seek arbitrage. Individual firms will use foreign exchange transactions either to finance a specific exchange of goods with a foreign agent or to hedge against risk of currency fluctuations when there is a difference between production and payment period. Spot trades will mainly be used for the concrete trade of goods while future contracts will mainly be used to hedge against currency risk. We do, however, also expect that many participants in the futures market are speculators conducting arbitrage transactions.

There is a well-developed OTC market for foreign exchange derivatives. These so- called forward contracts serve as an almost equally attractive alternative to exchange based futures contracts. In response to a tax on

future contracts we would thus expect a large shift from futures to forwards as was the case in the Swedish example, as discussed above.

This presents an isolated argument for either only imposing a tax on the spot trade of foreign exchange as opposed to derivatives trading and/or imposing a tax on both exchange based transactions and OTC based transactions. As discussed in Section 4.1, economic theory suggests that such a tax should be imposed on OTC and exchange based trade instead of an isolated tax on spot trades.

OTC transactions are, however, inherently more difficult to administer – as opposed to exchange based trading - since they rely on institutions self-reporting and not regularly updated statements from exchange houses. As argued above a tax on OTC cannot be seen in isolation from other efforts to push OTC trading towards formal exchange based trading.

One should also interpret the differences between spot and derivatives trading with caution. Another potential explanation for the rather low estimates obtained in the studies on foreign exchange elasticities is that they mostly assume a currency transaction tax to be levied on all four major currencies EUR, USD, GBP and JPY.[38] This reduces obvious potential substitution alternatives and we would expect the elasticity to be higher if the tax was levied on only one currency. There do not however seem to be available studies on this.

It is less obvious from the empirical estimates that equity future contracts have a higher elasticity than spot trading (the estimate range is higher, but the average of estimates is rather similar). A priori we would have expected that equity future elasticities were higher than equity spot trading. Spot trading is normally a longer-term transaction that involves an exchange of property right over a stock. However, equity future contracts are often constructed as stock market indices where transactions are mainly arbitrage driven by seeking small price differences compared to the value of the underlying assets. Unfortunately, this cannot be documented from the available empirical estimates.

[38] See e.g. the section in Matheson (2011) on foreign exchange studies.

4.2.6. Learning point 6: A tax on interest rate derivatives would target the largest tax base

Interest rate derivatives constitute the largest amount of financial transactions (app. 64 percent in 2007) and thus provide the largest tax base.[39] We would a priori expect the elasticity of interest rate derivatives to be relatively high, since these transactions are often used to manage cash flows and are characterised by being short term, low-profit margin and frequent which are characteristics particularly sensitive to transaction cost increases.

We have located a single study estimating the elasticity on transactions in US Treasury bond futures,[40] and this estimate does not confirm our a priori argument. The article finds an elasticity of 1.169, which is relatively similar to the estimates found for equity transactions, cf. Table 4.4

4.2.7. Learning point 7: High profit margin markets are less elastic than low profit margin markets.

In low profit margin markets there will be a larger share of transactions that will become unprofitable due to a tax and hence the reduction in volume will be greater and the revenue potential smaller.

High and low profit margin markets are linked with real activity and arbitrage possibilities respectively. Arbitrage trading involves seeking out small price differences in the market. This helps ensure efficient price formation. Such transaction types are typically very sensitive to small changes in transaction costs since the economic benefit of each transaction is very small. On the other hand, transactions linked to real activity are less elastic since financial transaction costs contribute with a lower share in the cost-benefit calculation.

There is evidence suggesting that arbitrage trading constitute a large and growing part of total transactions especially in foreign exchange.[41] The

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[39] Copenhagen Economics based on data from BIS, WFE and IMF collected and kindly shared by Darvas and Weizsäcker (2010).

[40] See Wang et al. (1997).

[41] BIS estimates that 85 pct of the increase in daily average turnover between 2007 and 2010 comes from ”other financial institutions” where the main contribution within this category appears to come from high frequency traders, bank trading

growth is mainly due to electronic trading which has increased competition and lowered transaction costs and has given rise to algorithmic trading (particularly high frequency trading in spot markets of major currency pairs) where bids automatically are submitted in response to a particular algorithm. This high frequency strategy relies highly on low transaction costs, which suggest that the elasticity of the foreign exchange spot market should be increasing in response to the growing amount of high frequency trading taking place.

We have not found any empirical articles testing this hypothesis.

4.2.8. Learning point 8: Long term trading seem less elastic than short term trading

Markets with a lot of short term trading will tend to be more transaction-intensive and hence have a greater potential response to a tax increase. This also suggests that taxes imposed on arbitrage seeking transactions will lead to a larger reduction in transaction volume than a tax on transactions linked to real activity.

4.2.9. Learning point 9: Elasticities are expected to change over time

We would a priori expect elasticities to be increasing over time. This could be the case both as a response to the increased amount available financial instrument and therefore substitution alternatives but also because the transaction infrastructure has changed over time. As mentioned above, evidence suggests that high frequency (arbitrage) trading has grown significantly over time. Since this trading strategy is more sensitive to transaction costs we would expect the elasticity to be higher when high frequency trading constitutes a larger share of total transaction.

Automated electronic trading is more used in e.g. spot transactions when there is no counterparty credit risk associated with the transaction. In e.g. the foreign exchange swap market automated transactions have grown more slowly. This would also suggest that spot markets would see a higher growth in the elasticity over time than e.g. swap or future markets.

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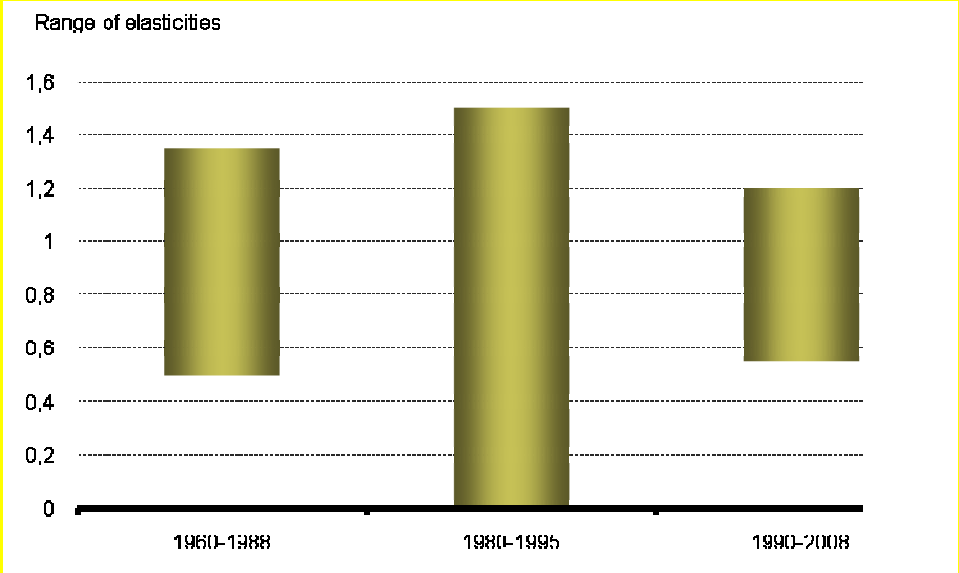
as clients of the largest FX dealers and retail investors trading online. See BIS Quarterly Review December 2010.

The available empirical evidence does not however; seem to provide convincing documentation for this argument. Figure 4.5 shows the range of available estimates divided into time categories. However, few studies use recent data and few studies control for potential time variation in the elasticity size.

Figure 4.5 Elasticities on equity spot transactions by time period evaluated



Note: The time periods overlap somewhat since the categories have been designed to allow for the best fit of the data used in the literature. The studies used are described in Table 0.4.

Source:Copenhagen Economics.

4.3. Concluding remarks

The response of the tax base in reaction to a tax is of crucial importance for the tax revenue potential. This is of particular importance when considering taxation of financial transactions since financial markets can deliver innovative products with similar economic effect, thus providing available alternatives to the product, which the transaction tax is levied upon. In the context of designing a financial transaction tax, we have discussed obvious product substitution alternatives and argued that the revenue potential of a potential tax depends on whether it successfully can include these obvious substitution alternatives in the tax base. Moreover, to secure a stable revenue over time such a tax should include even less obvious alternatives which the market has incentives to create in order to bypass the tax. This is not an easy task.

By surveying the available empirical literature on financial transaction tax elasticities we have presented a number of learning points. All of these learning points are backed by the theoretical literature and some (but not all) can be confirmed by empirical elasticity estimates. In the cases where empirical estimates are available we have presented these. One of the learning points is that one should be careful in generally extrapolating elasticity estimates which can depend on the specific region analysed, the time period analysed and the estimation technique used. Moreover, several specific learning points in relation to taxing available substitution alternatives are extracted.

Table 4.5 Securities transaction taxes in G20 and selected other countries, 2010

Country	Capital Levy	Equity	Bonds/ Loans	Forex	Options	Futures	Capital inflow
Argentina	N.a.	Federal stamp duty on share transfers abolished 2001	Provincial stamp tax, usually at 1%, may affect bonds and debentures	N.a.	N.a.	N.a.	N.a.
Australia	N.a.	State-level taxes may apply to shares	State-level taxes may apply to loans and bonds	N.a.	N.a.	N.a.	N.a.
Brazil	N.a.	1.5% tax on equity issued abroad as depository receipts (reduced from 3% 2008)	1.5% tax on loans (reduced from 3% in 2008)	0.38% on forex; 5.28% on short-term forex (<90 days)	N.a.	N.a.	2% tax on capital inflows to stock and bond markets since 2009
Canada	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.
Chile	N.a.		0.1-1.2% tax on bond issuance	N.a.	N.a.	N.a.	N.a.
China	N.a.	0.1% of principal	N.a.	N.a.	N.a.	N.a.	N.a.
France	5% of capital contributions not subject to VAT	15-30 bps tax abolished 1/1/2008	N.a.	N.a.	N.a.	N.a.	N.a.
Germany	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.
Hong Kong	N.a.	10 basis points	N.a.	N.a.	N.a.	N.a.	N.a.
India	N.a.	0.25% on stock price; 0.025% on intraday transactions; local stamp taxes may also apply	Local stamp duties may apply		0.017% on premium; 0.125% on strike	0.017% of delivery price	Na

Indonesia	N.a.	0.1% on value of shares; local stamp duties may also apply	Local stamp duties may apply	N.a.	N.a.	N.a.	N.a.
Italy	Euro 168 flat fee on share issuance; 3% on business purchases	0.01-0.14% of shares traded off exchange	0.25-2% on loan principal	N.a.	N.a.	N.a.	N.a.
Japan	Registration tax of 0.4% on mergers and trusts	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.
Mexico	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.
Russia	Capital duty of 0.2% of value of new share issues, but not upon formation or IPO of company		Capital duty of 0.2% of value of new bond issues, but not upon formation or IPO of company	N.a.	N.a.	N.a.	N.a.
Saudi Arabia	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.	N.a.
Singapore	N.a.	20 basis points	N.a.	N.a.	N.a.	N.a.	N.a.
South Africa	N.a.	0.25% of value; new share issues excluded	N.a.	N.a.	N.a.	N.a.	N.a.
South Korea	0.1-0.4% tax on capital formation	0.5% on value of shares in corporations or partnerships	N.a.	N.a.	N.a.	N.a.	N.a.
Switzerland	1% on share issuance in excess of CHF 1 mill.	15 bps on domestic shares; 30 bps on foreign shares	6-12 bps on bond issuance	N.a.	N.a.	N.a.	N.a.

Taiwan	N.a.	30 basis points	10 basis points on corporate bond principal	N.a.	10-60 basis points on premiums	Up to 0.025 basis points on interest rate futures; up to 6 basis points on stock index and other futures	N.a.	
Turkey	Stock issuance charge 0.2%	Initial charge for obtaining stock market quote: 0.1%; annual maintenance charge 0.025%	0.6-0.75% bond issuance charge	0.1% tax on foreign exchange transactions by financial institutions eliminated 2008	N.a.	N.a.	N.a.	
UK	N.a.	Stamp duty 0.5% on secondary sales of shares and trusts holding shares	N.a.	N.a.	50 bps on strike price, if executed	50 bps on delivery price	N.a.	
US	N.a.	SEC fees on stock trading: 0.0013%; NY state tax: $0.05 per share up to $350 per trade	N.a.	N.a.	N.a.	N.a.	N.a.	

Source:Matheson (2011).

APPENDIX LITERATURE REVIEW OF TAX ELASTICITIES IN THE FINANCIAL AND NON-FINANCIAL SECTOR

Table 0.1 Tax elasticity and location in the financial sector

Study	Time	Geography	Dependant variable	Methodology	Tax measure	Elasticity in the financial sector	Elasticity in other sectors	Conclusions	Sectors

Overesch and Wasmer (2009)	2005	30 EU countries	Number of German outbound FDI in respective countries	Poisson regression using count data on the number of German outbound FDI in 30 EU countries in 2005	STR and EATR	Elasticity of financial sector wrt to STR (EATR) is -1.8 (-1.9) and semi-elasticity of financial sector wrt STR (EATR) is that of -5.8 (-6.6)	STR (EATR) elasticity of -0.8 (-0.7) and a semi elasticity of -2.5 (- 2.4) across all sectors	FDI is inversely related to tax rates and the exact effect is asymmetry across sectors	All and divided in to manufacturing sector (heavy and non-heavy industry) and Non-manufacturing sector (Business service, wholesale, Financial services, Holdings, R&D and residual Group)
Stöwhase (2005a)	1995-1999	From 8 EU countries to Germany, the Netherlands and the UK	Bilateral FDI	Panel data regression on bilateral FDI from eight EU countries to Germany, the Netherlands and the UK during the period 1995-1999	EMTR	STR (EATR) elasticity of -2.3 (-0.4) in the tertiary sector	No tax response in the primary sector. STR (EATR) elasticity of -1.4 (0.3) in the secondary sector	Irrespective of the tax measure, the tax elasticity of tertiary sector is 20% to 30% above the average elasticity	Divided into Primary, Secondary and Tertiary sector (including financial intermediation
Stöwhase (2005b)	1991-1998	8 host countries (Austria, Belgium, France, Ireland; Italy, the Netherlands, Spain and the UK	German Multinationals abroad	Count data regression on the number of German MNEs in Austria, Belgium, France, Ireland, Italy, the Netherlands, Spain and the UK during 1991-1998	EATR and STR	STR elasticity of - 6.6 in the service and finance sector. No response to EATR	EATR elasticity is -2.0 in the production sector. No response to STR	Separation of different types of FDI has an impact on the tax elasticities, where the STR affects service and finance while EATR affects production sector	Divide FDI into two Production and Service, Finance and R &D

Note: EMTR-Effective marginal tax rate, EATR-Effective average tax rate, STR, Statutory tax rate, MNEs-Multinational enterprises and when only elasticity or semi-elastic is given in a study; we transform them to semi-elastic or elasticity using the given mean tax rate across the sample country and year.
Source: Copenhagen Economics.

Table 0.2 Tax elasticity and profit in the financial sector

Study	Time	Geography	Dependant variable	Methodology	Tax measure	Elasticity and semi elasticity	Conclusions	Sectors
Demirguc-Kurt and Huizinga (2001)	1988-1995	80 countries around the world	Pre-tax profits of the banking sector in domestic and foreign owned banks	Pooled OLS	STR and ATR	Elasticity of pre-tax profit in domestic owned bank wrt STR (ATR) is0.03 (0.04) while foreign owned bank is that of -0.02(-0.02)	Higher tax rates increase tax revenue collected from national banks and decreases revenue collected from multinational banks, which is explained by the profit shifting activity of foreign banks	Banking Sector
Albertazzi and Gambacorat (2006)	1980-2003	10 countries and 8 of them are Euro area countries (Germany, France, Italy, Spain, the Netherlands, Austria, Portugal and Belgium)	Income statement component of banking sector (such as net interest income, non-interest income, profit before taxes and others)	Dynamic panel data-GMM	STR	Elasticity of pre tax profit, Net interest income, other income, operating costs and provision in banking sector wrt STR are 1.06, 0.09,-0,41,0 and 0 respectively, While the semi-elasticity of pre tax profit, Net interest income, other income in banking sector wrt STR are 2.50,0.22 and -0.96 respectively.	Predicts non-linear relation ship between tax and net interest income and high profit shifting activity in the banking sector for an increase tax.	Banking sector

Note: EMTR-Effective marginal tax rate, EATR-Effective average tax rate, STR, Statutory tax rate, MNEs-Multinational enterprises and when only elasticity or semi-elastic is given in a study; we transform them to semi-elastic or elasticity using the given mean tax rate across the sample country and year.
Source: Copenhagen Economics.

Table 0.3 Impact of taxation of on currency trading transactions

Study	Time	Geography	Dependant variable	Technique	Elasticity	Conclusions
Schmidt (2007)	Monthly data from Feb. 1986-Mar. 2006	USD, EUR, GBP, YEN	Forex trading volume	3 Stage Least Square	Elasticity of forex with respect to tax is -0.43	Currency transaction tax has negative impact on trading volume
Bismans and Damette (2008)	Nov. 2004-Nov. 2005	Four currencies traded	Forex trading volume	SUR and Panel estimation	The overall elasticity of forex volume with respect to transaction tax is -0.60	Forex trading volume could be significantly reduced by the Tobin tax. Nevertheless, elasticities are heterogeneous with respect to the currency pairs: the largest elasticities are the Euro/Dollar and Sterling/Dollar currency pairs that are the most traded exchange parities

Source: Copenhagen Economics.

Table 0.4 Impact of taxation on stock share trading

Study	Time	Geography	Dependant variable	Technique	Elasticity	Conclusions
Baltagi et al. (2006)	Nov. 1996-Nov. 1997	China	Stock trading volume	Bootstrap method (comparing the mean value of volume before and after the event)	Elasticity of trading volume (turnover) with respect to transaction cost is -1 and elasticity of turnover with respect to tax increase is -0.5	The trading activity response to a transaction tax could potentially be very large and the market becomes more volatile after an increase in tax
Yongyang and Zheng (2010)	1991-2008	China	Trading volume pre tax and post tax adjustment	Bootstrap method, GARCH	Elasticity of trading volume with respect to transaction cost is found to be -0.55 and -4 when transaction tax increase and decrease respectively	Large reaction of transaction volume of in response to a tax
Umlauf (1993)	1980-1987	Sweden	Return of shares	Measuring daily returns because of the change in transaction tax	1% TT announced results in reduction of return by -2.2% and an increase in TT to 2% results -0.8% reduction in return	A large proportion of trading activity migrated overseas to London when tax rate was increased to 2% in 1986
Liu (2007)	1987-1991	Japan	Stock trading volume	Simple regression	The reduction in the STT was associated with an increase in yen trading volume, after controlling for changes in stock price and volatility	Any public policy that helps to reduce transaction costs should boost market efficiency
Hu (1998)	1975-1994	Hong Kong, Japan, Korea and Taiwan	Stock trading volume	Test of equality of standard deviation of return and mean of turnover	Elasticity of market turnover with respect to tax rate is zero	On average, an increase in tax rate reduces the stock price but has no significant effect on market volatility and market turnover
Westerholm (2003)	1990-1993	Sweden and Finland	Stock trading volume	Pooled cross section regression with auto-distributive log model.	Long run elasticity of trading volume wrt. transaction costs is about 1 for Sweden and 1.3 for Finland	Changes in transaction taxes (STT's) have significant impact on the price level and the trading activity in Sweden and Finland

Ericsson and Lindgren (1992)	1980-1989	23 different countries	Stock market trading volume	Simple regression	Elasticity of trading volume wrt. transaction costs is between 1.2-1.5	A decrease in transaction taxes will lead to large increases in the turnover rate of stock exchanges

Source: Copenhagen Economics.

Table 0.5 Impact of taxation on transactions in future market

Study	Time	Geography	Dependant variable	Technique	Elasticity	Conclusions	Sectors
Aliber. et al. (2003)	1977-1999	Four currencies in US dollar- British pond, Deutsche Mark, the Japanese Yen and Swiss Franc	Trading volume (number of contracts)	Panel OLS and SUR	Elasticity wrt. transaction tax 0.5-1.25	The increase in transaction tax leads to a reduction in volume of trade	Forex market
Chou and Wang (2006)	1999-2001	Taiwan	Volume of equity futures	General method of moment (GMM)	Elasticity of trading volume with respect to transaction tax is 1.042	Trading volume will increase for a decrease in transaction tax, however price volatility has not increased with a reduction in transaction tax	Future market
Norden (2009)	2005-2007	Sweden	Volume of equity futures	Non-linear two stage least square	A 22% reduction in transaction tax results 19% increase in volume of trade which corresponds to an elasticity of 0.855	The exchange fee reduction has improved futures market liquidity at the cost of higher volatility. Moreover, the attractiveness and competitiveness of the futures exchange has increased relative alternative trading volumes, without a loss of revenues in the process	Future markets
Wang et al. (1997)	1990-1994	US	Transaction volume of various future products including Treasury bonds, equity, foreign exchange, agriculture commodities and metal commodities	2-SLS and OLS	Elasticity of futures differs with respect to the underlying security. Estimates vary from 0.1 on agriculture commodities to 2.72 on foreign exchange futures	Trading volume has a negative relation ship with transaction tax	Future markets
Wang and Yau (2000)	1990-1994	Chicago Mercantile Exchange (CME) and Deutsche mark futures (DM)	Transaction volume on various future products including equity, foreign exchange and metal commodities	GMM	Elasticity of CME and DM with respect to TT is -0.776 and -1.301 in the short run and	The Imposition of transaction tax will reduce the trade volume	Future markets

						-1.230 and -2.058 in the long run respectively		

Source: Copenhagen Economics.

Table 0.6. Tax elasticity in the non-financial sector

Study	Time	Geography	Dependant Variable	Technique	Tax measure	Elasticity and semi elasticity	Conclusions	Sectors
Riedl and Rocha-akis (2009)	1982-2005	17 OECD countries	Corporate income tax (CIT) base per capita i.e. the amount of firm's profits to the nominal corporate income tax rate	Fixed effect estimations	A forward looking Effective average tax rates (EATR)	Long run CIT base elasticity to be -0.71 for unilateral CIT rate reduction while they find elasticity of 0.134 for each country if all 16 countries reduce CIT tax rate by 1% at the same time	A unilateral increase in CIT might reduce the corporate profit in the long run, but this might not be the case if countries coordinate and increase their CIT together	All
Weichenrieder (2009)	1996-2003	German inbound and outbound FDI to and from the EU	Winsorised return on total assets	Fixed effect estimations	Corporate tax rate	Semi elasticity (elasticity) of rate of return on assets of German inbound FDI with respect to tax rate of parent country is 0.049 (0.017)	Find an empirical correlation between the home country tax rate of parent and the net of tax profitability of its German affiliate that is consistent with profit shifting activity	Affiliates in the banking and insurance industries are excluded
Overesch and Schreiber (2008)	1996-2005	Firm-level data on German outbound FDI in 36 countries and 29 of them are in European countries	Stock of fixed assets (PPE)	-	STR	Semi-elasticity of -0.622 of investment in fixed assets to STR in the short run and -1.65 in the long run	Suggest that the negative effect of an increasing STR on investment can be eliminated if the country R&D intensity is high in the country	Sum up different sectors

Buettner and Wamser (2007)	1996-2004	German multinationals which has more than one country affiliates (in total 79 countries)	The share of internal debt related to loans from other, non-German affiliates	Fixed effect estimations	STR of corporate income tax (they have used the tax rate differential within company group)	Semi-elasticity and elasticity of internal debt ratio as 0.64 and 0.068 respectively to a one percentage point increase in tax-rate difference to the specific group	The higher the tax rate differences in two German Multinationals abroad, the higher will be the profit shifting activity through internal loan from higher tax rate to lower tax rate German subsidiaries	All
Huizinga and Laeven (2008)	1999	32 European countries	Earning before taxes and interest	OLS, IV estimations	STR	The average semi elasticity and elasticity of pre-tax profits to STR are found to be -1.33 and -0.45 respectively. Larger EU countries such as German have lower elasticity compare the smaller countries	There is a substantial profit shifting activity in Europe from high tax to low tax rate countries. This profit shifting leads to a significant redistribution of national corporate revenue with German lost the highest revenue through profit shifting	Manufacturing sector
Swenson (1994)	1979-1991	US as a host country and the rest of the world as a source	FDI in different industries in US	OLS and GLS	Average tax rate and effective tax rate	Elasticity of FDI to average tax rate is 0.9278 to all industry together, 0.7723 to manufacturing sector and 1.0453 to (Finance and real estate sector together), where as elasticity of FDI to effective tax rate is -1.118 to all sectors and 0.0271 to manufacturing and -1.66 to financial and real-estate sector	An increase tax in US in 1980's increases inward FDI in industries and states that this superior performance of the then tax rate is probably caused by the predominance of mergers and acquisitions in foreign investment	The regression is based on all industries (18) Manufacturing and financial and real estate (together)
Hansson and Olofsdotter (2010)	1995-2006	EU27 and EU15	Net FDI outflows investing to host country	Heckman estimation technique is used as there is many zero values in the FDI	The difference between host and investing corporate tax rates in the EU27 captured by STR and EMTR	Semi elasticity of -3.736 and -4.716 to STR and EMTR respectively when FDI flows from EU15 to new member states (excluding Malta and Cyprus). However, they have not found significant elasticity when FDI flows within EU27 or within EU15. And further suggested that FDI in manufacturing sector is deterred by higher taxes but no such effect seemed to be found in service sector	Large tax rate differences have strong impact on flow of FDI from EU15 to the new Member States	All sectors and divided in to manufacturing and service sectors

Mills and Newberry (2004)	1987-1996	US	Foreign controlled corporation taxable income affiliates in the US at company level	Panel data technique	The difference between US STR and average foreign tax rate of foreign multinationals	Semi-elasticity of 0.12 in use of debt among foreign held affiliates with respect to US tax rate	Foreign multinationals with relatively low average foreign tax rates report less taxable income and use more debt in their foreign controlled corporations than those with relatively high average foreign tax rates	Manufacturing sector
Dwenger and Steiner (2009)	1998-2001	Germany	Corporate tax base which is captured by Adjusted Gross Income (AGI)	Instrumental approach as average effective corporate tax rate (ETR) can be endogenous and pseudo panel data- OLS and 2SLS	Backward-looking measure of the (ETR)	Elasticity of over all AGI wrt ETR is -0.53. And elasticity of AGI wrt ETR is -0.6 and -0.38 in manufacturing and primary plus tertiary sectors, respectively	Find negative relation ship between AGI and ERT. And this relationship is more pronounced in manufacturing sector than primary plus tertiary sector. Such result came from profit shifting activity than other	All sectors and divide into manufacturing (secondary), primary plus service sector (tertiary sector)
Mintz and Smart (2003)	1986-1999	Canada's six province	Real taxable corporate income per capita	Difference in difference method	STR	Elasticity of lager subsidiaries wrt net tax rate is found to be 4.9 and semi-elasticity of tax rate is to be -8.5	Multijurisdictional firms operating through subsidiaries are able to use income shifting activity to avoid substantial amounts of provincial corporate tax in Canada	Primary, Construction, Manufacturing, Transportation, Communications and Utilities and others. Financial corporations are excluded
Hines and Rice (1990)	1982	59 host countries	Non-financial income of US MNEs	Cross sectional data	STR	Semi-elasticity of foreign tax rate to be -3.2	An increase tax rate in host country will reduce US outbound FDI	Non-financial sector
Bartelsman and Beetsma (2003)	1979-1997	22 OECD countries	Value added reported and non reported	OLS based on production function	STR	65% of additional revenue from a 1% point increase in the local tax is lost due to transfer pricing	A substantial share of the revenues from a unilateral increase in the STR is lost because of a decline in reported income	Manufacturing sector

Clausing (2003)	1997-1999	US	Import and export prices of US based firms	Simple regression	STR	Semi-elasticity of -2 and 2 for import and export prices in intra-firm trade respectively with respect to foreign tax rate	Controlling for other variables that affect trade prices, as country tax rates are lower, US intra-firm export prices are lower, and US intra-firm import prices are higher - confirming tax motivated income shifting behaviour	All
Ramb and Weichenrider (2005)	1996-2002	Germany	Foreign held affiliates in Germany	Panel data technique -FE	STR	Semi-elasticity of intra-company loans wrt German tax rate is found to be -0.14	Corporate tax rate of the foreign parent has no significant impact on the financial structure of a German subsidiary. However, among subsidiaries that are directly held by a foreign investor those firms that on average are profitable react more strongly to changes in the German corporate tax rate than this is the case for less profitable firms	Non-financial sector
Grubert and Slemrod (1998)	1982	US corporations in Puerto Rico	After tax profit	Tobit and probit model	STR	Not explicitly given	Income shifting advantages are the predominant reason for US investment in Puerto Rico	Manufacturing sector
Grubert and Rauh (2005)	1960-2003	US	Corporate taxable income	IV	METR	Elasticity of corporate tax base wrt EMTR is -0.2	Corporate tax base is responsive to the marginal effective tax rate	All
Buettner et al. (2006)	1996-2004	24 countries, most of them are from EU	German outbound, represented by debt/asset ratio	Fixed effects	STR	Semi-elasticity varies from 0.34 to 0.44	Sensitivity of investment to STR is found to be higher in countries where a thin-capitalization rule is imposed (a rule which deny interest deductions on intercompany debt if debt-equity ratio exceed certain thresholds)	All
Clausing (2007)	1979-2002	29 OECD countries	Corporate tax revenue/ GDP	Simple regeression	STR	Parabolic relationship between tax rates and revenue with revenue maximizing STR of 33% for the whole sample	The revenue maximising rate is found to be decrease as economies are smaller and more integrated with world economy	All

Brill and Hassett (2007)	1980-2005	29 OECD countries	Corporate tax revenue/ GDP	Simple regeression	STR	Parabolic relationship between tax rates and revenue with revenue - maximizing STR of 26% for the whole sample	The revenue maximising rate is found to be decrease as economies are smaller and more integrated with world economy	All
Grubert and Mutti (1991)	1982	US real capital controlled by MNCs in 33 countries	After tax profit	Simple regression	EATR and STR	Not explicitly given	US appears both to import more from and export more to low-tax countries where MNC investment is greater	Manufacturing sector

Note: EMTR-Effective marginal tax rate, EATR-Effective average tax rate, STR, Statutory tax rate, MNEs-Multinational enterprises and when only elasticity or semi-elastic is given in a study; we transform them to semi-elastic or elasticity using the given mean tax rate across the sample country and year.
Source: Copenhagen Economics.

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ANNEX 10

IMPACTS ON EFFECTIVE TAX RATES, THE COST OF CAPITAL AND INTEREST RATE SPREADS

This Annex illustrates the effects of the tax instruments discussed in the main document on the behaviour of banking and financial intermediaries. In particular, consistent with the traditional framework to assess the impacts of taxation on the incentives to accumulate capital, the effects on the user cost of capital, and the related concepts of effective tax rates, will be reviewed. Given the crucial functions performed by banks in the economy, investigating the potential effects of taxation on the rates and the credit market is also of particular interest. In this context, as the literature on banking regulation has highlighted the existence of a link between lending and capital requirements, in investigating the impacts of bank taxes on lending rates and volumes the interaction with regulatory provisions on equity capital is explicitly taken into account.

1. FINANCIAL TRANSACTION TAXES

The effects of transaction taxes on firms' behaviour have been investigated particularly for the case of securities. A general theoretical result is that that higher transactions costs, including those imposed by transaction taxes, are associated with lower asset prices (Kupiecs, 1996). Investors facing higher costs to acquire a security require a higher return from holding it, and thus bid the price down. This may increase the cost of capital faced by firms, which in turn would translate into lower investment at the macroeconomic level.

In a simple framework for the valuation of the firm, Matheson (2011) analyses the effects of a securities transactions tax (STT) on share prices and on the cost of capital, and finds that a STT is akin to a permanent increase in the firm's discount rate[1]. While the effect on the cost of capital is derived in Box 9.1, considering the case of a transactions tax levied once per transaction at the ad valorem rate T, the proportional reduction in the value of a security (Δ) following the STT is, under simplifying assumptions:

$$\Delta = 1 - \frac{1 - e^{-RN}}{1 - (1 - T)e^{-RN}},$$

with $R = r - g$, where r is the discount rate and g the growth rate of dividends, and N is the holding period.

Box 9.1. STTs and the cost of capital (Matheson, 2011)

Consider a firm that maximizes the dividend stream, given by:

$$\sum_t (1 - \vartheta_t) D_t (1 + r)^{-t},$$

[1] A STT is defined as a tax on trades in all or certain types of securities (equity, debt and their derivatives). It may include original issuance (similar to a capital levy), or be restricted to secondary market trades.

where ϑ_t is the dividend tax rate at *t*. in the absence of equity finance, dividends are given by $D_t = F(K_t) - I_t$, with $K_t = I_t + (1-\delta)K_{t-1}$, where, as usual, K indicates the capital stock, I is investment and δ is the economic depreciation rate. After substituting, the maximand becomes:

$$\sum_t (1-\vartheta_t)\left[F(K_t) - K_t + (1-\delta)K_{t-1}\right](1+r)^{-t}.$$

Differentiating with respect to K_t and setting equality to zero gives:

$$(1-\vartheta_t)\left(F'(K_t) - 1\right) + (1-\vartheta_{t+1})(1+r)^{-t}(1-\delta)(1+r)^{-1} = 0$$

Rearranging, the value-maximizing marginal product of capital can be expressed as:

$$F'(K_t) = 1 - (1-\vartheta_{t+1})(1-\vartheta_t)^{-1}(1-\delta)(1+r)^{-1}.$$

Imposing $\vartheta_t = 0$ and $\vartheta_{t+1} = (1/N)T$, with 1/N the probability of selling the share at t+1 and T the ad valorem transaction tax rate, the expression becomes:

$$F'(K_t) = \left[(r+\delta) + (1-\delta)T/N\right](1+r)^{-1}.$$

Hence, the STT increases the cost of capital by the second term on the right hand side of the equation, and is roughly equivalent to an increase in the firm's discount rate by *T/N*.

The table shows that the effects on the security prices and on the cost of capital increase in the tax rate and are dampened with longer holding periods (see Table 9.1). By raising transactions costs, a STT would also increase the average holding period of securities, particularly for securities with initially narrow bid-ask spreads. In turn, this would reduce the impact of the tax on securities values and capital costs. As corporate bonds are generally traded less frequently than stocks, a given STT would likely impact corporate borrowing costs less heavily then stocks.

Empirical studies of the impact of STTs on financial markets generally confirm the theoretical proposition that they reduce asset prices (Umlauf, 1993; Hu, 1998). Bond, Hawkins and Klemm (2005) find that the 50 % cut in the UK stamp duty enacted in 1986 increased share prices, particularly for shares with high turnover rates. They predict that eliminating the remaining 50 basis point stamp duty would increase share prices between 2.5 and 6.3 percent, with the size of the effects depending negatively on dividend yield and positively on market turnover. STTs are therefore capitalized more heavily into the prices of assets with high turnover, such as large-capitalization stocks. Schwert and Seguin (1993) estimate that the increase in the cost of capital following a 0.5% STT in the US would be between 10 and 180 basis points. Oxera (2007) estimates that abolition of the 0.5% UK stamp duty would increase share prices by 7.2% and reduce the cost of capital by between 66 and 80 basis points. The magnitude of the impacts of STTs depends positively on the frequency with which shares are traded.

The negative impact of transaction taxes on investment is not confined to taxes applicable to securities. Albuquerque (2006) builds a dynamic general equilibrium (DGE) to analyse different bank account debits (BAD) taxes, of the type of the Provisional Contribution on Financial Transactions (CMPF) implemented in Brazil (see Annex 8). In a framework of

utility-maximising households, BAD taxes introduce a distortionary effect on the interest and dividend rates (through the Euler equations). The steady-state interest and dividend rates are found to increase with the tax rate and the turnover. The effect on the dividend rate implies that even with a small rate the tax can cause disinvestment and thus be detrimental to capital accumulation.

In general, bank transaction taxes (BTTs) can have detrimental effects on the functioning of both financial markets and the real economy. Since banks collecting BTTs usually charge higher interest rate spreads to recoup profitability, investment is discouraged. Likewise, BTTs also tend to encourage vertical integration of production processes, regardless of efficiency, as following the cascading effect through the production chain which results in multiple layers of tax on goods and services produced using bank-mediated transfers. Kirilenko and Summers (2004) have stressed that the erosion of the tax base taking place by removing funds from financial intermediaries has effects that go well beyond the revenue shortfall, given the role of the banking sector in the economy. A consequence of disintermediation would be the misallocation of financial funds, with a far reaching potential impact on the financing of investment projects. In fact, the experience with BTTs in Latin America has shown that this type of taxes, in addition to generating revenues which are substantially declining over time (Coelho, 2009; Baca-Campodónico, de Mello and Kirilenko, 2006), tend to be associated with significant substitution into cash, relocation of bank transactions into off-shore centres, development and adoption of new financial instruments and practices.

Table 9.1

Percentage Reduction in Security Valuation due to an STT

	Average Holding Period (Years)							
Tax Rate (T), Basis Points	**0.10**	**0.25**	**0.5**	**1**	**2**	**3**	**3.7**	**10**
1	3.2%	1.3%	0.7%	0.3%	0.2%	0.1%	0.1%	0.0%
5	14.3%	6.2%	3.2%	1.6%	0.8%	0.5%	0.4%	0.1%
10	25.0%	11.7%	6.2%	3.2%	1.6%	1.1%	0.8%	0.3%
50	62.5%	39.9%	24.9%	14.1%	7.5%	5.0%	4.1%	1.4%

Discount rate less dividend growth rate: R = 0.03

Increase in Cost of Capital - Percentage Points

	Average Holding Period (Years)							
Tax Rate (T), Basis Points	**0.10**	**0.25**	**0.5**	**1**	**2**	**3**	**3.7**	**10**
1	0.10	0.04	0.02	0.01	0.01	0.00	0.00	0.00
5	0.50	0.20	0.10	0.05	0.03	0.02	0.01	0.01
10	1.00	0.40	0.20	0.10	0.05	0.03	0.03	0.01
50	5.00	2.00	1.00	0.50	0.25	0.17	0.14	0.05

Source: Matheson (2011)

2. TAXES ON BANK PROFITS AND REMUNERATIONS

Taxation of income from capital is traditionally analysed using the concepts of effective tax rates. While the standard approach has focused on marginal investment decisions, leading to the formulation of effective marginal tax rates (EMTR) based on the cost of capital, a complementary approach looks at discrete choices among alternative investment projects, for which the relevant measure is the effective average tax rate (EATR). As the EATR encompasses the EMTR for marginal projects, it is reviewed here in its general formulation, and then the measures for a cash-flow type of profit tax are derived. Subsequently, an alternative EMTR which takes into account all the inputs (i.e. labour in addition to capital) is presented, alongside the implications for a cash-flow type of profit tax.

2.1. The EATR methodology

The effective average tax rate (EATR) developed by Devereux and Griffith (2003) provides a popular forward-looking measure of capital taxation considering a one-period perturbation of the capital stock of a firm. It is defined as follows:

$$EATR = \frac{R^* - R}{p/(1+r)}, \qquad (1)$$

where R^* is the present discounted value of the economic rents earned from the investment project in the absence of taxes, R is the same with taxation, p is the pre-tax net income stream discounted using the real interest rate r.

It is possible to show that, in the absence of taxes, the economic rent generated by an investment is:

$$R^* = -1 + \frac{(1+\pi)(p+\delta) + (1+\pi)(1-\delta)}{(1+i)} = \frac{p-r}{1+r}, \qquad (2)$$

with I the nominal interest rate, π the inflation rate, δ the economic depreciation rate of the capital stock.

When taxes are introduced, the source of financing also affects the rents. In particular, if the investment is financed with retained earnings, the rents are:

$$R^{RE} = -\gamma(1-A) + \frac{\gamma}{1+\rho}\left[(1+\pi)(p+\delta)(1-t) + (1+\pi)(1-\delta)(1-A)\right], \qquad (3)$$

where t is the rate of taxation of corporate income, A is the present discounted value of tax allowances per unit of investment (with a rate of fiscal depreciation per period equal to φ), ρ is the investor discount rate, $\rho=(1-m^i)i/(1-z)$, with m^i being the shareholder's marginal personal income tax rate on interest income and z the tax on capital gains, and $\gamma=(1-m^d)/(1-z)$ is a factor measuring the difference in treatment of new equity and distributions with m^d the personal tax rate on dividends. In the case of alternative sources of finance, additional financing cost needs to be added to this equation, or $R=R^{RE}+F$. In the case of finance by new equity (NE) and debt (D), the addendums are, respectively, $F^{NE} = -\rho(1-\gamma)(1-\varphi t)/(1+\rho)$ and $F^D = \gamma(1-\varphi t)(\rho - i(1-t))/(1+\rho)$.

As shown by Devereux and Griffith (2003), in the absence of personal taxes on interest income and capital gains, the EATR on a marginal project is equal to the EMTR, which can then be expressed as:

$$EMTR = \frac{\tilde{p} - r}{\tilde{p}} \qquad (4)$$

where $\tilde{p}$ is the cost of capital, i.e. the solution to $R=0$, as required in the case of a marginal investment.

In this general setting it is possible to verify the result that a cash-flow type of taxation for corporate income which allows immediate expensing of investment and no deductions for interest payments does not affect the cost of capital, and hence leads to a null EMTR (see, for instance, King (1987)). Consider the case of retained earnings financing as in (3), which gives the following expression for the cost of capital:

$$\widetilde{p} = \frac{(1-A)[\rho + \delta(1+\pi) - \pi]}{(1-t)(1+\pi)} - \delta \,. \tag{5}$$

Recalling that if the investment cost is fully expensed when it is incurred, then $A=t$, and substituting gives: $\widetilde{p}^{cf} = (\rho - \pi)/(1+\pi)$. Substituting into equation (4), the numerator of the EMTR simplifies to $\rho - \pi - r(1+\pi) = 0$, since $(1+r)(1+\pi)=1+I$ and $\rho=I$ without personal taxes.

The cash-flow type of taxes however will still lead to positive EATRs. Recalling that $\varphi = 1$, $A=t$ and no deduction is allowed for interest payments, it is possible to show that the EATRs are:

$$EATR^{RE} = \frac{\dfrac{(p-r)}{1+r} - (1-t)\gamma[-1 + (1+\pi)(1+p)/(1+\rho)]}{\dfrac{p}{1+r}}, \tag{6}$$

$$EATR^{NE} = EATR^{RE} + \frac{(1-t)(1+\gamma)\rho/(1+\rho)}{\dfrac{p}{1+r}}, \text{ and} \tag{7}$$

$$EATR^{D} = EATR^{RE} + \frac{(1-t)\gamma(\rho - i)/(1+\rho)]}{\dfrac{p}{1+r}}. \tag{8}$$

Consider a tax levied at 5% rate on cash-flow profits. Abstracting from capital gain and personal taxes, if one assumes a pre-tax rate of return of 20%, in the presence of a 5% real interest rate and 2% inflation, the EATR is 3.75%[2]. Of course, having in mind the design of the FAT, one should take into account that the same statutory rate falls on the labour compensation. The next section illustrates an alternative methodology that explicitly incorporates the labour input into the calculation of the effective tax burden.

2.2. A PRODUCTION BASED APPROACH TO MEASURE MARGINAL EFFECTIVE TAX RATES

McKenzie, Mintz and Scharf (1997) have proposed a 'production approach', as opposed to the traditional 'investment approach' to derive effective marginal tax rates which take into

[2] Absent personal taxation and levies on capital gains, the way of financing the investment (whether through retained earnings or through debt) does not affect the average tax burden.

account taxes levied on all inputs. As such, this approach seems particularly promising to analyse a financial activities tax levied on profits and remunerations, hence on the capital and labour factors. The sketch of the methodology provided here follows strictly the adapted model proposed by McKenzie (2000) to calculate effective taxes on banks. The methodology can be implemented in three steps, which allow the calculation of the effective tax rates on: i) each of the inputs; ii) the marginal cost function; iii) output.

i) The effective tax rate on capital is given by the effective marginal tax rate, obtainable using the methodology of King and Fullerton (1984) and Devereux and Griffith (2003). As shown above, the marginal rate for a cash flow profit tax is zero. As far as the marginal rate on labour is concerned, the key issue is to identify the 'marginal' worker. In the presence of a flat rate applicable to payroll the marginal rate would be given by the rate itself.

ii) The rates on the inputs are aggregated to obtain the rate on the marginal cost function (MC), T^i, which solves $(1+T^i)\ MC(q; p^0) = MC(q; p')$, where q denotes the output and W^0 (W') is a vector of input prices before (after) taxation. Assuming a bank that 'produces' loans (L) using capital (K) and labour (N), $MC(q; p')=MC(L; p^K(1+\beta^K t^K), p^N(1+\beta^N t^N))$, where t^i are the marginal tax rates and β^i the tax shifting factors, $0 \leq \beta^i \leq 1$[3]. In particular, when $\beta^i = 1$ the tax is fully shifted forward to the demand side for the input, and the user cost changes by the full amount of the tax. On the other hand, when $\beta^i = 0$ the tax is fully borne by the supply side, hence the user cost is unaffected by it. In the intermediate case, the user cost increase by some fraction of the tax. Finally, aggregating the effective marginal tax rates requires the choice of a functional form for the production function. Two commonly used forms are:

a. the Cobb-Douglas (with elasticity of substitution among the inputs equal to 1) leads to $T^i = \left(1+\beta^K t^K\right)^{A^K}\left(1+\beta^N t^N\right)^{A^N} - 1$

b. the Leontief, or fixed proportions (with elasticity of substitution among the inputs equal to 0) leads to $T^i = A^K\left(1+\beta^K t^K\right) + A^N\left(1+\beta^N t^N\right) - 1$,

where the A^i are the factors shares.

iii) The effect of taxes on the marginal revenues needs to be taken into account. Following the tax, one should observe an upward shift of the marginal cost curve, together with a downward shift of the marginal revenue schedule. In the model of McKenzie (2000), banks are price takers in the loan market. The net effect is a reduction in the number of loans. The equilibrium condition for profit maximisation without taxes is:

$$r^l{}_l = MC(.)(\rho + f) \qquad \Leftrightarrow \qquad r^n \equiv r^l / MC(.) - f = \rho \tag{9}$$

where r^l is the loan rate, assumed as given, and f is the loans loss rate. Finally, ρ is the opportunity cost of finance, or $\rho = \sigma r^e + (1-\sigma) r^d$ where r^e (r^d) is the rate of return required by equity owners (depositors), and σ the proportion of the marginal loan financed by retained earnings[4]. In the equilibrium condition above, r_n is defined as the net rate of return on a marginal loan net of default risk.

The equilibrium condition for profit maximisation in the presence of taxes is:

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[3] $\beta^i = (\varepsilon^i{}_s)/(\varepsilon^i{}_s + \varepsilon^i{}_d)$, with $\varepsilon^i{}_s$ ($\varepsilon^i{}_d$) the elasticity of supply (demand).

[4] In the model, only retained earnings and deposits are the two sources of finance for the bank.

$$r^l(1-t) = (1+T^i)MC(.)(\rho+f) \quad (10)$$

which, combined with the condition (9), gives the gross-of-tax return r_g on issuing an additional loan leading to the net-of-tax return r_n:

$$r^g = r^l(1+T^i)(\rho+f)/r^l(1-t) - f \quad (11)$$

Combining the net and the gross rates, one can obtain the effective marginal tax rate on bank loans as: $t^l = (r^g - r^n)/r^g$.

To fix ideas, a simple numerical example can be worked out as follows. Suppose a 5% tax is levied on cash-flow profits and remunerations. As clarified above under i), in the absence of other taxes the marginal rate on capital will be zero, whereas that on labour is 5%. Consider further the aggregation under ii), and a pass-though of the labour tax of 50%. Using a value for the labour share equal to 52%, the Cobb-Douglas production function gives an effective rate on intermediation costs of 1.29%, while the fixed proportions function leads to a marginal effective rate of 1.3%[5]. Finally, applying the steps under iii) one obtains a marginal effective rate on loans in the range of 29%[6]. The rather high order of magnitude, broadly consistent with the evidence for the US and Canada calculated in McKenzie (2000), is indeed a result of the combined effect of taxes on the cost of intermediating bank loans, which arise from the taxation of bank inputs, and the reduction in the marginal revenue from issuing the loan.

3. EFFECTS ON BANKS ASSET GROWTH AND RISK: EMPIRICS

Since a reduction of after-tax returns discourages expansion of investment, an increase in bank taxes is likely to impact negatively on bank asset growth. In addition, reduced after-tax earnings make retaining earnings more costly, adversely affecting capital formation, which in turn discourages asset growth. Moreover, a reduction in asset growth and (after-tax) profitability, coupled with more costly capital formation, can also translate into higher bank risk. De Nicolò (2010) quantifies those potential impacts with respect to two specific tax instruments: a Financial Stability Contribution (FSC) and a FAT[7].

First, using a large unbalanced panel of US banks during 1995-2009, the author estimates forecasting models of equity formation, bank assets growth and the probability of default. As expected, a lower return on assets due to an increase in corporate taxation has a negative impact on capital formation, asset growth, and translates in an increase in the probability of default. In addition, a higher effective tax rate reduces asset growth, while higher asset growth also reduces the probability of default.

From the equations in the levels, first difference equilibrium relationships are obtained relating the change in taxation to the change in asset growth and probability of default. The hypothetical cases considered are:

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[5] The share of labour compensation over gross value added for financial corporations is obtained using the Annual Sectoral Accounts from Eurostat.

[6] The calculations assume a ROE of 10%; a rate on deposits of 2.06% and a loan loss rate of 4.2%. These values are obtained from the ECB Statistical Warehouse and ECB (2010). The share of equity financing for the marginal loan is assumed equal to 5.05%.

[7] See IMF (2010) for the definitions.

- FSC taxes of 10, 50 and 100 basis points applied to total debt and to total liabilities net of equity capital;
- a Financial Activity Tax (FAT) assumed to be 2 percent (200 basis points) of profits before taxes.

The results show a limited median impact of FSC and FAT on asset growth (the point estimates do not exceed a decline of 0.07% under the highest FSC tax rate and base), with extreme values of sizable magnitude, however. By contrast, the impact of FSC and FAT on the probability of default is very small, with the maximum over all banks reaching 0.12 %.

In the second step of the analysis, the impact on real activity is derived using an estimated elasticity for GDP growth to bank assets growth of 0.07%, obtained from a panel of 48 countries in the period 1980-2007. The FSC and the FAT have a very limited median impact on GDP growth. However, the impact of these taxes could have more significant adverse real effects in the worst case scenario in which most banks would implement a contraction in asset growth closer to the estimated maximum for large banks.

4. BANK TAXES IN THE PRESENCE OF CAPITAL REQUIREMENTS: A THEORETICAL FRAMEWORK

In this section the effects of bank taxes is analyzed using an adapted version of the basic Monti-Klein model (Freixas and Rochet, 2007). In particular, the model allows one to study the effects of a tax on profits (and of a bank levy) on banks' behaviour and profitability, as well as the combined effect of regulation, in a very stylized setting.

The bank is a monopolist facing a downward-sloping demand for loans $L(r_L)$ and an upward-sloping supply of deposits, $D(r_D)$. In what follows, it is more convenient to work with the inverse demand functions, as follows: $r_L(L)$ and $r_D(D)$. Likewise, it is useful to define the effect of taxes on the relevant functions. Consider a generic profit tax of h_L. The (inverse) demand function for loans now becomes $r_L(\bar{L}, \bar{h}_L)$, where the superscripts indicate the sign of the partial derivatives. The conditions in the demand for loans reflect the fact that higher interest rates or higher taxes reduce the number of investment projects with positive net present value. In particular, an increase in the tax rate h_L, keeping the amount of demanded loans unchanged, reduces the level of r_L. By the same token, consider a tax on deposits h_D on deposits. The inverse supply schedule denotes the interest rate required by depositors in order to supply resources equal to D. A tax falling on deposits implies that for given D, depositors increase the required rate r_D. Hence, $r_D(\overset{+}{D}, \overset{+}{h}_D)$, where the superscripts indicate the sign of the partial derivative as before.

The bank's cost function is assumed to be linear and separable:

$$C = \gamma_D D + \gamma_L L, \tag{12}$$

with γ's positive cost parameters. The profit function looks like:

$$\Pi = r_L(L)L - r_D(D)D - rI - pL - C \tag{13}$$

where *I* denotes the net interbank liabilities, on which the bank pays the money market rate of *r*, exogenously given, and provisions are assumed to be a constant fraction *p* of loans.

Banks are subject to capital requirements, which, following the literature, are assumed to be always binding. This implies that the amount of equity is a given fraction *0<k<1* of loans, or *E=kL*. Taking into account all the elements above, the balance sheet constraint is:

$$L = D + E + I\,, \tag{14}$$

Finally, in the spirit of Caminal (2003), it is assumed that the bank is a licence holder, with no private wealth, so that equity needs to be raised on the market. Denoting v the value of the licence, η the net rate of return required by outside investors and φ the proportion of the bank owned by them, then φ is determined by the following no arbitrage condition:

$$\frac{\varphi\Pi}{E-v} = 1+\eta\,. \tag{15}$$

The left hand side is the amount of profits accruing to outside investors expressed as a ratio of their disbursement. Such return is assumed to be equal to $1+\eta$, the return to outside investors on their alternative option.

A tax on bank profits

The analysis builds upon Albertazzi and Gambacorta (2007). In the basic framework outlined above, a tax at rate τ on profits generates a fiscal effect on the cost of equity. Profits in equation (15) have to be netted of the tax, yielding the following:

$$\frac{\varphi\Pi(1-\tau)}{E-v} = 1+\eta\,. \tag{16}$$

Rearranging, one can express the fraction of profits accruing to the licence holder as:

$$(1-\varphi)\Pi = \Pi - \frac{1+\eta}{1-\tau}E + \frac{1+\eta}{1-\tau}v\,. \tag{17}$$

Taking into account equations (12)-(16), the maximization problem can then be written as:

$$\underset{L,D}{\text{Max}}\,(1-\tau)\left[r_L L - \widetilde{\gamma}_L L - r_D D + \gamma_D D + rD + \frac{1+\eta}{1-\tau}v\right],$$

with $\widetilde{\gamma}_L = \gamma_L + p + k\frac{1+\eta}{1-\tau} + (1-k)r,$ a term akin to an adjusted marginal cost which indicates that, in addition to operational expenses, loans involve costs in terms of provisions, capital requirements and money market interest rate, for non-equity finance. As a result of full separability, a tax on profits has no effect on the equilibrium on the deposits market. It affects the lending side through two channels: the marginal cost of outside equity $(1+\eta)/(1-\tau)$ and the demand for loans. Formally, this can be seen first by deriving the first order conditions (FOCs), as follows:

$$\begin{cases} \dfrac{d\Pi}{dL} = (r_L)_L L + r_L - \widetilde{\gamma}_L = 0 & \Leftrightarrow r_L^{\,*} = \widetilde{\gamma}_L / (1 - 1/\varepsilon_L) \\ \dfrac{d\Pi}{dD} = r - (r_D)_D D - r_D - \gamma_D = 0 & \Leftrightarrow r_D^{\,*} = (r - \gamma_D)/(1 + 1/\varepsilon_D) \end{cases}$$

where $(r_L)_L \equiv dr_L/dL(<0)$ and $(r_D)_D \equiv dr_D/dD(>0)$, while ε_L and ε_D are the elasticities of the demand for loans and of the supply of deposits, henceforth assumed constant[8].

Simple comparative statics shows the effect of the variables of interest on the equilibrium. In particular, the effects of the profit tax on quantities can be examined by totally differentiating the FOCs, yielding:

$$\frac{dL^*}{d\tau} = -\frac{(r_L)_\tau - (1 - 1/\varepsilon_L)^{-1}(\widetilde{\gamma}_L)_\tau}{(r_L)_L} = -\frac{(r_L)_\tau - (1 - 1/\varepsilon_L)^{-1} k(1+\eta)(1-\tau)^{-2}}{(r_L)_L} < 0, \text{ and}$$

$$\frac{dD^*}{d\tau} = 0,$$

where $(r_L)_\tau \equiv dr_L/d\tau < 0$ denotes the partial derivative of the inverse demand function with respect to the tax rate. The null effect of the tax on deposits is because the rate and the cost for deposits are not affected by the tax. We concentrate on the loans market.

In a similar way, the effect of tighter regulation for bank capital on lending volumes can be analysed using comparative statics for the parameter *k*, as follows:

$$\frac{dL^*}{dk} = -\frac{-(1 - 1/\varepsilon_L)^{-1}(\widetilde{\gamma}_L)_k}{(r_L)_L} = -\frac{-(1 - 1/\varepsilon_L)^{-1}(1+\eta)(1-\tau)^{-1}}{(r_L)_L} < 0 .$$

Hence, both a tax on profits and tighter regulatory requirements will decrease lending volumes. The latter effect is the so-called "bank capital channel", which captures how shocks to a bank's capital affect the level and composition of its assets. As highlighted in FSA (2009), such channel operates under the conditions that: (i) banks do not hold excess capital with which to isolate credit supply form regulatory changes; (ii) raising capital is costly for banks; (iii) there is positive demand for bank credit.

What happens to equilibrium rates? It is easy to verify that

$$\frac{dr_L^{\,*}}{d\tau} = (1 - 1/\varepsilon_L)^{-1}(\widetilde{\gamma}_L)_\tau > 0, \text{ and}$$

$$\frac{dr_L^{\,*}}{dk} = (1 - 1/\varepsilon_L)^{-1}(\widetilde{\gamma}_L)_k > 0.$$

[8] In formulas: $\varepsilon_L \equiv -(dL/dr_L)(r_L/L) > 0$ and $\varepsilon_D \equiv (dD/dr_D)(r_D/D) > 0$. Other standard assumptions on the size of the elasticities as well as on the second order conditions are satisfied.

Again, both an increase in the tax rate and tighter capital requirements operate in the same direction of increasing the cost of credit. The cross-derivative that captures the combined effect of taxation and regulation on the loan rate is: $\frac{dr_L^*}{dkd\tau} = \left(1-1/\varepsilon_L\right)^{-1}\left(\widetilde{\gamma}_L\right)_{k\tau} > 0$.

It bears a positive sign like the cross-derivative of the marginal cost function. Hence, each of the instrument considered (tax rate and regulatory requirement) reinforces the marginal effect of the other on the cost of credit.

Bank levies

Following the recent experience with the implementation of this type of instrument, we analyse a bank levy impacting on the liabilities side of the bank balance sheet. In particular, in the in the stylized framework presented above two alternative bases for a bank levy – with a rate of λ – will be introduced: *i*) deposits not falling under a guarantee scheme; *ii*) total liabilities excluding equity capital and insured deposits. The choice of the base is shown to have significant effects on the equilibrium and its comparative statistics properties.

i) A levy on uninsured deposits

Defining *g* the fraction of insured deposits, the base for the levy is $(1-g)D$.

Taking into account the arbitrage condition under (15), the maximisation problem for the licence-holder bank becomes:

$$\underset{L,D}{\text{Max}}\left[r_L L - \hat{\gamma}_L L - r_D D + \hat{\gamma}_D D + rD + (1+\eta)v\right]$$

with $\hat{\gamma}_L = \gamma_L + p + k(1+\eta) + (1-k)r$, and $\hat{\gamma}_D = \gamma_D + \lambda(1-g)$. As before $\hat{\gamma}_L$ is an adjusted marginal cost on loans which indicates that, in addition to operational expenses, loans involve costs in terms of provisions, capital requirements and money market interest payments. It is easy to verify that $\hat{\gamma}_L < \widetilde{\gamma}_L$, since the marginal cost of outside equity is lower, absent the tax on profits, ceteris paribus. On the other hand, the marginal cost of deposits needs to be adjusted for the levy, which de facto becomes an additional cost component proportional to the fraction of uninsured deposits. Thus, deposit insurance acts like a subsidy that affects banks' marginal cost proportionally to the rate of the levy.

The FOCs from profits maximisation are:

$$\begin{cases} \dfrac{d\Pi}{dL} = \left(r_L\right)_L L + r_L - \hat{\gamma}_{\mathrm{L}} = 0 & \Leftrightarrow r_L^* = \hat{\gamma}_{\mathrm{L}} / \left(1-1/\varepsilon_L\right) \\ \dfrac{d\Pi}{dD} = r - \left(r_D\right)_D D - r_D - \hat{\gamma}_{\mathrm{D}} = 0 & \Leftrightarrow r_D^* = \left(r - \hat{\gamma}_{\mathrm{D}}\right)/\left(1+1/\varepsilon_D\right) \end{cases}$$

As before, comparative statics can be used to assess the effect on the equilibrium of changes in the levy rate as well as the impacts of tighter regulatory requirements on capital. From the discussion above it is clear that while the levy will impact on the market for deposits, the regulatory requirements affect uniquely the loans market. In particular, when it comes to equilibrium quantities, the effects of the levy are:

$$\frac{dD^*}{d\lambda} = -\frac{(r_D)_\lambda - (1+1/\varepsilon_D)^{-1}(\hat{\gamma}_D)_\lambda}{(r_D)_D} = -\frac{(r_D)_\lambda + (1+1/\varepsilon_D)^{-1}(1-g)}{(r_D)_D} < 0, \text{ and}$$

$$\frac{dL^*}{d\lambda} = 0.$$

As before, the adjustments following tighter regulation, that is an increase in the parameter k denoting the fraction of loans to be covered by equity, will take place on the loans market. In particular:

$$\frac{dL^*}{dk} = -\frac{-(1-1/\varepsilon_L)^{-1}(\hat{\gamma}_L)_k}{(r_L)_L} = -\frac{-(1-1/\varepsilon_L)^{-1}(1+\eta)}{(r_L)_L} < 0$$

Comparative statics on the equilibrium rates gives:

$$\frac{dr_D^*}{d\lambda} = -(1+1/\varepsilon_D)^{-1}(\hat{\gamma}_D)_\lambda < 0, \text{ and}$$

$$\frac{dr_L^*}{dk} = (1-1/\varepsilon_L)^{-1}(\hat{\gamma}_L)_k > 0.$$

Hence, while the levy affects only the deposits market, capital requirements still act through the credit channel. As a result of separability between deposits and loans, the cross-effects of regulation and taxes are nil:

$$\frac{dr_L^*}{dkd\lambda} = 0; \frac{dr_D^*}{dkd\lambda} = 0.$$

ii) A levy on liabilities

The second type of bank levy considers total liabilities excluding equity capital and insured deposits as a base, or:

$$E + D + I - (E + gD) = I + (1 - g)D,$$

where, as before, g is the fraction of deposits falling under a guarantee scheme. Compared to the previous case, now the base for the levy is broader as it includes also the net interbank liabilities.

Taking into account the arbitrage condition under (15), the maximisation problem for the licence-holder bank becomes:

$$\underset{L,D}{\text{Max}} \left[r_L L - \bar{\gamma}_L L - r_D D + \bar{\gamma}_D D + rD + (1+\eta)v \right]$$

with $\bar{\gamma}_L = \gamma_L + p + k(1+\eta) + (1-k)(r+\lambda)$, and $\bar{\gamma}_D = \gamma_D - g$. As before $\bar{\gamma}_L$ is an adjusted marginal cost on loans, including operational expenses, provisions, capital requirements and money market interest payments. Interestingly, compared to the previous case, now the levy becomes an additional cost component associated with loans through the money market channel. Indeed, it is easy to verify that $\bar{\gamma}_L > \hat{\gamma}_L$. On the other hand, the marginal cost of deposits needs to be adjusted downwards due the presence of the guarantee scheme, implying $\bar{\gamma}_D < \hat{\gamma}_D$.

The FOCs from profits maximisation are:

$$\begin{cases} \dfrac{d\Pi}{dL} = \left(r_L\right)_L L + r_L - \bar{\gamma}_{\mathrm{L}} = 0 & \Leftrightarrow r_L^* = \bar{\gamma}_L / \left(1 - 1/\varepsilon_L\right) \\ \dfrac{d\Pi}{dD} = r - \left(r_D\right)_D D - r_D - \bar{\gamma}_{\mathrm{D}} = 0 & \Leftrightarrow r_D^* = \left(r - \bar{\gamma}_{\mathrm{D}}\right) / \left(1 + 1/\varepsilon_D\right) \end{cases}$$

As before, comparative statics can be used to assess the effect on the equilibrium of changes in the levy rate as well as the impacts of tighter regulatory requirements on capital. From the discussion above it is clear that in this case the levy will impact on the loans market through its effects on interbank financing. In particular, when it comes to equilibrium quantities, the effects of the levy are:

$$\frac{dD^*}{d\lambda} = 0, \text{and}$$

$$\frac{dL^*}{d\lambda} = \frac{\left(r_L\right)_\lambda - \left(1 + 1/\varepsilon_D\right)^{-1} \left(\bar{\gamma}_L\right)_\lambda}{\left(r_L\right)_L} < 0.$$

As before, the regulatory requirements affect uniquely the loans market. The effect of tighter regulation is then:

$$\frac{dL^*}{dk} = -\frac{-\left(1-1/\varepsilon_L\right)^{-1}\left(\bar{\gamma}_L\right)_k}{\left(r_L\right)_L} < 0\,.$$

Comparative statics on the equilibrium rates gives:

$$\frac{dr_L^*}{d\lambda} = \left(1 - 1/\varepsilon_L\right)^{-1}\left(\bar{\gamma}_L\right)_\lambda > 0, \text{ and}$$

$$\frac{dr_L^*}{dk} = \left(1 - 1/\varepsilon_L\right)^{-1}\left(\bar{\gamma}_L\right)_k > 0.$$

The cross-effects of regulation and taxes on the equilibrium loan rate are:

$$\frac{d^2 r_L^*}{dkd\lambda} = -\left(1 - 1/\varepsilon_L\right)^{-1} < 0.$$

Hence, a higher levy on liabilities (excluding equity capital) counteracts the effects of tighter regulation on the loans rate, which increases now at a decreasing rate.

5. COMPARISON AND CONCLUSIONS

The partial equilibrium analysis above illustrates the different impacts of taxes on profits and bank levies on the behaviour of a monopolist bank in a Monti-Klein type of model. The comparative statics results show that tighter prudential regulation increases the interest rate charged on loans and reduces credit ("bank capital channel"). While a tax on profits has similar effects on the equilibrium in the loans market, the impacts of a bank levy depend on the definition of the base. On the one hand, at the margin, a levy on deposits only – with the exclusion of those covered by insurance schemes – decreases both quantities and rates on the market for such liability. On the other hand, when the base is extended to all liabilities – with the exclusion of insured deposits and capital – the adjustments take place again on the loan market, where quantities decrease and rate are higher.

Finally, it is interesting to compare the effects of regulation on rates in the presence of different tax instruments, as follows:

$$\left.\frac{dr_L^*}{dk}\right|_\lambda^{I+(1-g)D} < \left.\frac{dr_L^*}{dk}\right|_\lambda^{(1-g)D} < \left.\frac{dr_L^*}{dk}\right|_\tau^{\Pi},$$

where the subscript indicates the case of levies (λ) or taxes (τ), while the superscript indicates the relevant base, as defined above. Thus, the increase in the cost of credit following tighter capital requirements is lower under a bank levy on riskier liabilities, whereas it is the highest in the case of a profit tax.

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IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

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ANNEX 11

REVENUE POTENTIAL OF FTT AND FAT

1 PRELIMINARY REMARKS

Before presenting the available data and methodology, a general remark on tax revenue estimates for new tax instruments should be made. Estimating revenue changes when reforming existing taxes is already a difficult task since behavioural changes due to tax rate or base changes are often difficult to predict. Estimating revenue for taxes which would be newly introduced and which have the goal to change market behaviour and structure significantly is not feasible without a high degree of uncertainty. This is especially the case for the taxation of derivatives where no data on potential reactions when taxing the notional value is available.

The FAT is more similar to some existing taxes and revenue estimates are more meaningful for this tax. Therefore, the results of the revenue estimates presented below should be interpreted with great caution and can perhaps serve to give some order of magnitude, but even this is not. Moreover, notwithstanding the often substantial projected receipts, the consequences of governments increasing their reliance on this relatively volatile sector for their revenues should be considered carefully.

2 ESTIMATES FOR REVENUES FROM FTT

2.1. Methodology and recent revenue estimates

The revenue potential of an FTT is considered to be substantial.[1] Schulmeister (2011) estimates that Europe (including Norway and Switzerland) could raise around EUR 310 billion (1.8% of GDP of the countries involved) in 2010 with a tax rate of 0.05%. This is based on the assumption that trade volumes decrease by 3.8% in spot markets, by 69.2% in exchange traded derivatives and by 68.6% in OTC derivative markets. Despite the reductions in volumes, the derivatives markets generate the major part of revenues in these estimates (95%) due to the taxation of the notional value which constitutes a very large tax base. The largest share of these revenues (62%) is collected in the UK. McCulloch and Pacillo (2011) give an extensive review of the literature on revenue estimates as well as the underlying data on transactions costs. They also present an estimate of the revenue of an FTT at global level to be between USD 147 and 577 billion without OTC contracts and USD 482 to 1,631 billion including OTC markets. They define the tax rate in terms of the percent increase in transaction costs of products and assume increases of 10%, 20%, and 50%. Data on FX markets as well as OTC derivative trading is usually retrieved from the BIS.

[1] Not all studies see the FTT as a revenue raiser and a corrective device. In a study requested by the European Parliament's Committee on Economic and Monetary Affairs, von Weizsäcker and Darvas (2010) argue for a very small tax rate for an FTT to reach some regulatory objectives but are sceptical with regard to the FTT as a revenue raising instrument. They conclude: "*The case for a tax on financial transactions simply to raise more revenue from the financial sector to pay for the cost of the crisis is not particularly strong. Better alternatives to tax the financial sector are likely to be available*."

Other studies have taken different approaches to determine the revenue potential. Jetin and Denys (2005) proposed a specific formula for estimating transactions tax revenues. The authors base their approach on a study on currency transaction taxes by the French Ministry of Finance published in 2000. The formula is similar to assuming an arbitrary decrease of trade volume. Since the underlying structural model to explain the precise reaction of all market segments is not known, this formula should be interpreted as an educative guess of an estimate and as a tool to visualize relevant parameters. It is not an actual description of behavioural changes. A variant of this formula was also used by McCulloch and Pacillo (2011) and is also used here for different market segments. The assumption is that tax revenue R can be calculated as

$$R = \tau \cdot V \cdot E \cdot \left(1 + \frac{\tau}{c}\right)^{\varepsilon}$$

where τ is the tax rate, V the annual transaction volume, and E which is interpreted here as relocation and fiscal evasion. The variable c describes the transaction costs in percent of the transaction volume and ε is an elasticity which describes the effect of a tax increase on the transaction volume, i.e. the tax base.[2] The elasticities ε considered fort he formula range from zero (no reaction except for relocation and evasion E) to -2.

The elasticity values are based on results of Annex 9. Note that the elasticities found in the empirical literature are point estimates. This means that they have been calculated for specific trade volume, for a specific increase in transaction costs and for a specific institutional setting. It can also be interpreted as the transaction cost elasticity of the transaction volume since a tax increases the transaction costs in the case of a transaction tax. Note that the last term in brackets describes the volume reaction of markets due to an increase in transaction costs only. The relocation and evasion is captured directly by E. It is important to understand that the main difference between the estimates discussed in the policy debate recently and the figures presented here is the assumption about the strength of the relocation effect E, notably with regards to derivatives.

In order to understand better how the tax revenue depends on the tax rate in the formula chosen above it is useful to look at the first derivative of the function with respect to τ. The resulting expression shows under which condition the derivative is positive. In this case tax revenue R increase in τ. Since E and V are constant in this formulation assume for simplicity that they are both 1:

[2] In general, an elasticity is defined as the relative change in the dependent variable (here the transaction volume) to a relative change in the independent variable (here the tax rate). In other words, the elasticity measures the percentage change of the tax base if the tax rate changes by one percent.

$$R = \tau \cdot \left(1 + \frac{\tau}{c}\right)^{\varepsilon}$$

$$\frac{\partial R}{\partial \tau} = \left(1 + \frac{\tau}{c}\right)^{\varepsilon} + \tau \cdot \varepsilon \cdot \left(1 + \frac{\tau}{c}\right)^{\varepsilon - 1} \cdot \frac{1}{c}$$

$$= \left(1 + \frac{\tau}{c}\right)^{\varepsilon} \cdot \left(1 + \varepsilon \frac{\frac{\tau}{c}}{1 + \frac{\tau}{c}}\right)$$

The first term in the last line of the equation above is always positive since tax rate and transaction costs are positive. The elasticity ε takes values from 0 to -2 in the estimates below. The derivative will only be negative if ε is larger than 1 in absolute terms. For elasticities between 0 and -1 revenue will always increase in the tax rate (see figure 1a). Only for values larger than 1 there is a Laffer-curve effect where revenue could decrease in tax rates (see figure 1b). This is the standard case.

Figure (1a) Revenue as a function of the tax rate, tax rate range (0 to 1%), transaction cost 0.03%, Elasticity -1 transaction volume normalized to 1.

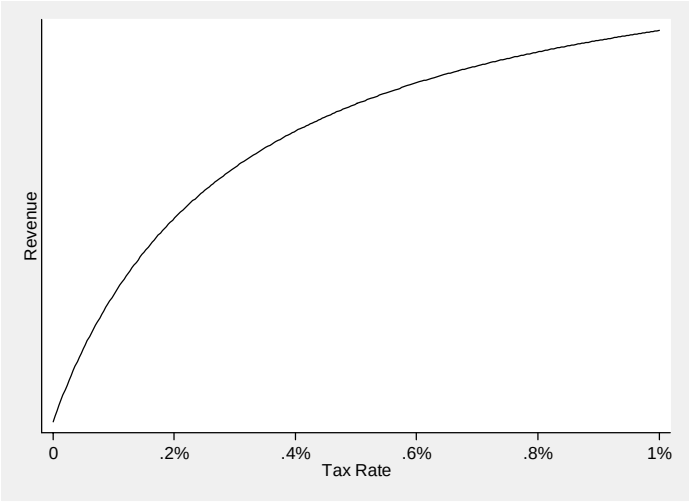
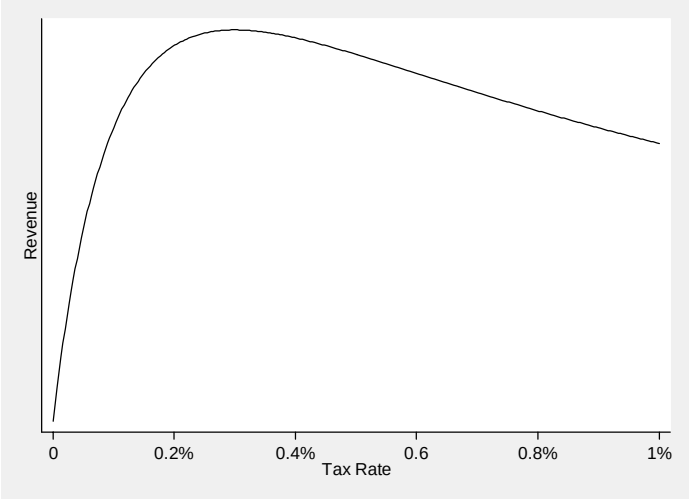


Figure (1b) Revenue as a function of the tax rate, tax rate range (0 to 1%), transaction cost 0.03%, Elasticity -2 transaction volume normalized to 1.



For the range of values of transaction costs, tax rates and elasticities used for the estimates below, the derivative is almost always positive. This means that in the tax rate range discussed here there is in general an increase of revenues in the tax rate. The only exception are estimates for the CTT since the transaction costs are very low which leads to an earlier Laffer-curve effect.

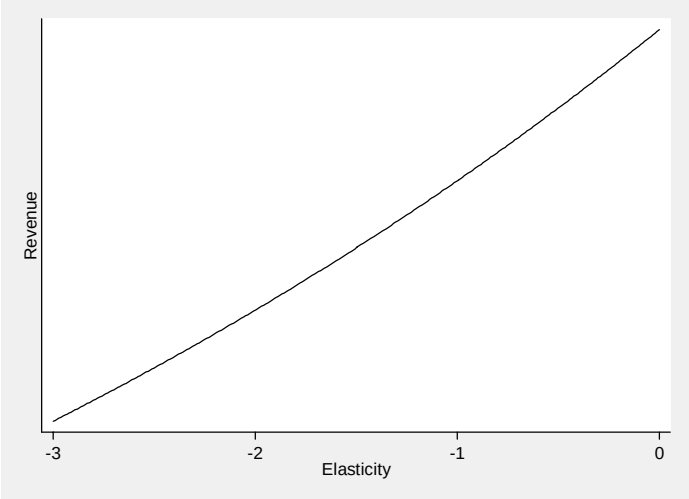
With regard to the elasticity, the first derivative is

$$R = \tau \cdot \left(1 + \frac{\tau}{c}\right)^{\varepsilon}$$

$$\frac{\partial R}{\partial \varepsilon} = \varepsilon \left(1 + \frac{\tau}{c}\right)^{\varepsilon - 1} < 0$$

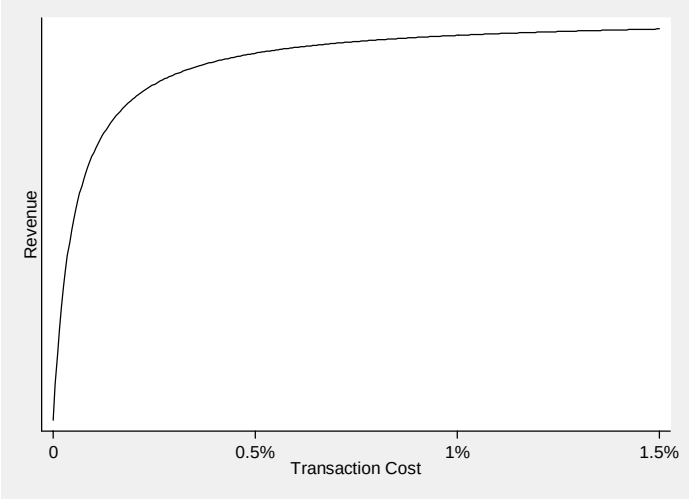
In this case it is straight forward to see that the derivative is negative as long as the elasticity is negative. Figure (2) illustrates the effect of the elasticity on the tax revenue given a tax rate of 0.05% and transaction costs of 0.03%.

Figure (2) Revenue as a function of the assumed elasticity, elasticity range (-3 to 0), transaction cost 0.03%, tax rate 0.05%, transaction volume normalized to 1



The transaction costs also influence the revenue collection. The basic idea is that lower transaction costs lead ceteris paribus to lower revenues. the reason is that the tax increases transaction costs relatively stronger when the latter are low. If transaction costs are very large, a small increase due to taxation does not have a strong effect.

Figure (3) Revenue as a function of the assumed pre-tax transaction costs in % of transaction volume, range (0 to 1.5%), tax rate 0.05%, elasticity 1, transaction volume normalized to 1



It is important to understand that the main difference between the estimates discussed in the policy debate recently and the figures presented here is the assumption about the strength of the relocation effect *E*. For reasons outlined in more detail below the estimates presented here differ from others mainly with regard to derivative taxation. The differences in estimates for spot market transactions are negligible. In fact, we rely otherwise on similar values with regard to transactions costs *c* like for example McCulloch and Pacillo (2011). Here the values used are however slightly lower to what they suggest for mainly one reason. The data they use is based on transaction cost estimates from the years 1980 to 1997 (except for the FX market). The assumption made here is that in the last 15 years transaction costs have been further

reduced due to IT developments. For this reason lower transaction costs for most product categories are assumed. They are summarized in Table (1). In the following, the formula presented above is used to calculate some rough revenue estimates.

Table (1) Assumptions about Transaction costs

Market Segment	Pre-tax transaction cost in % of transaction volume
Equity	0.06%
Bond	0.06%
Exchange Derivatives	0.03%
OTC Derivatives	0.07%
FX Spot Market	0.024%

It should be noted that the formula is fully based on assumptions. There is currently no structural model for the functional form of a revenue function for the different products taxed under a transaction tax. This should be taken in mind when interpreting the results.

2.2 Data sources

A. Federation of European Stock Exchanges

FESE collects data on exchange traded instruments in three categories: equities, fixed interest instruments (bonds) and exchange traded derivatives.

The FESE data is more comprehensive compared to other data sources like the World Federation of Exchanges (WfE) data which were used recently for similar estimates. 36 European Exchanges are covered in the data. Note that this entails also Non-EU countries since some exchanges are cross-border exchanges. The most important is the EUREX which is a Swiss and German exchange. Table (2) gives an overview of the exchanges available. Note that non-EU exchanges have been dropped from the sample unless a cross-border exchange contains at least one EU Member State.

The time period covered for all exchanges in the list is 2005 to 2009. For some exchanges the data is also available for a longer period; however for the purposes of this estimation a balanced panel is necessary to derive meaningful and comparable results for the EU-27. For this reason the years, where the not all changes are covered, have been dropped from the sample.

With regards to exchange traded products, the data covers three categories of products: Equities, Bonds and Derivatives. The data on equities admitted to trading on regulated markets can be divided in to four groups. Equities traded on Regulated Markets (RM), on Multilateral Trading Facilities (MTF) and Systematic Internalizers (SI) and Equity traded OTC. Not covered in the FESE is the equity trading in OTC markets. Assumptions about the

share of the latter vary widely and reported values range from 16 % to 38 %.[3] The reason for the differences in estimates is the different assumption about the degree of double counting in these transactions. For the purpose of this study the data will therefore not be used. Keep in mind that if all equity trading in OTC could also be taxed, tax revenues might be higher depending on the true share of OTC trading in all equity trading.

Table (2) Exchanges covered by FESE data

Exchange	**Countries**
Athens Exchange	GR
Athex Derivatives Market	GR
Austrian Derivatives Market	AT
Bratislava Stock Exchange	SK
Bucharest Stock Exchange	RO
Budapest CEESEG	HU
Bulgarian Stock Exchange	BG
Copenhagen NASDAQ OMX Nordic	DK
Copenhagen OMX Stock Exchange	DK
Cyprus Stock Exchange	CY
Deutsche Börse	DE
EUREX	DE, SW
Euronext Liffe	UK, FR, NL, BE, PT
Helsinki NASDAQ OMX Nordic	FI
Helsinki OMX Stock Exchange	FI
Iceland NASDAQ OMX Nordic	IS
Irish Stock Exchange	IE
Istanbul Exchange	TR
Italiana Borsa	IT
Ljubljana CEESEG	SI
London Stock Exchange	UK

[3] afme (2011) reports a value of 16 % while FESE (2011) estimates the value to be 38 %.

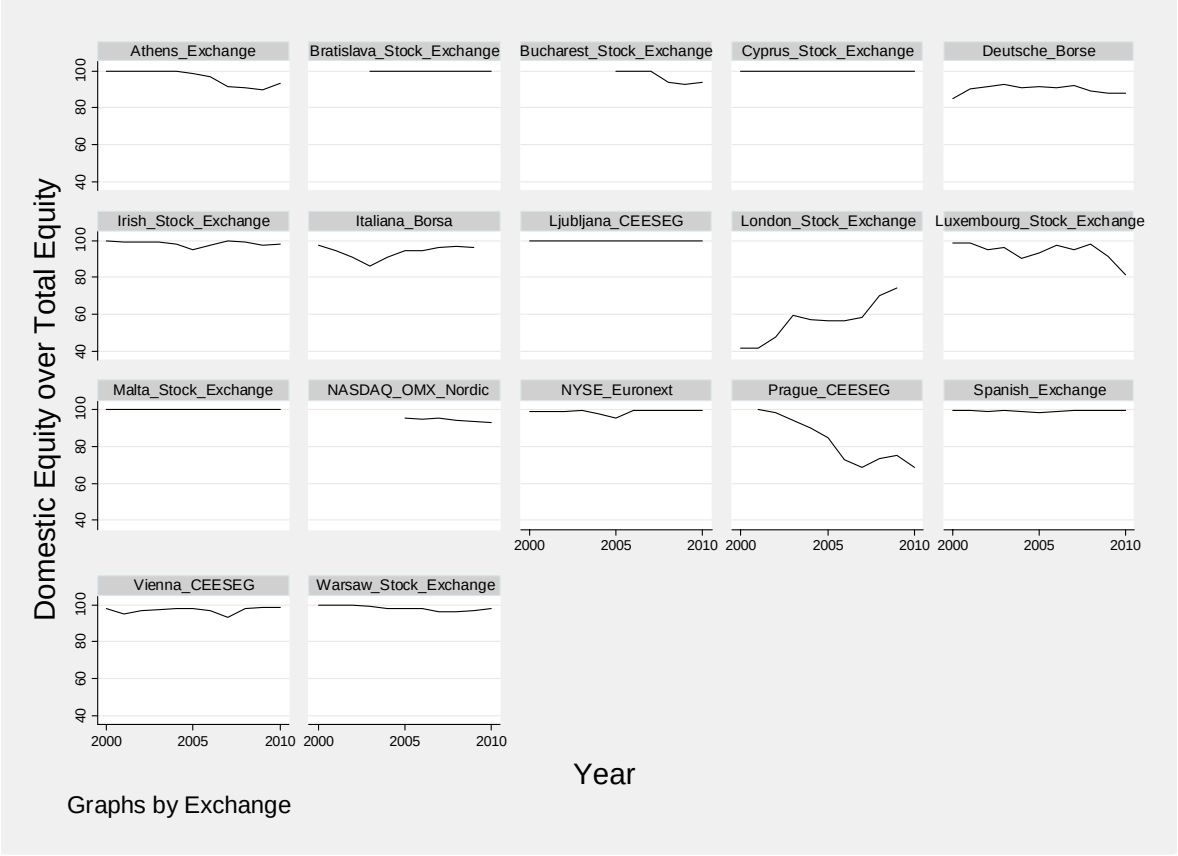
Luxembourg Stock Exchange	LU
Malta Stock Exchange	MT
NASDAQ OMX Nordic	DK, EE, FI, IS, LT, LV, SE
NYSE Euronext	BE, FR, NL, PT
OMX Nordic Exchange	DK, SE, FI, IS
Oslo Bors	NO
Prague CEESEG	CZ
SIX Swiss Exchange	SW
Spanish Exchange	ES
Stockholm NASDAQ OMX Nordic	SE
Stockholm OMX Stock Exchange	SE
Stuttgart Börse	DE
Vienna CEESEG	AT
Vilnius NASDAQ OMX Nordic	LT
Warsaw Stock Exchange	PL

For equities not admitted to regulated markets data is only available for those securities traded on an MTF. There is no information on privately placed equities or an estimation of their share.

The available data on equities is split in four categories of which only two are used, namely Electronic Order Book Transactions and Off-Electronic Order Book Transactions. Dark Pool Transactions and Reporting Transactions are not used due to the low number of observations. The latter two categories are not considered since too many observations are missing. Therefore, for exchange traded instruments (equities, bonds and derivatives) Electronic Order Book Transactions and Off - Electronic Order Book Transactions turnover volumes will be used in the tax base.

The FESE data also allows differentiating between trading in domestic and foreign equities: the share of domestic traded equity is in general very large in most Member states. Figure (4) shows the ratio for selected exchanges. The smallest share of domestic equities trading is executed at the London Stock Exchange. Note that foreign equities are exempted from the UK stamp duty (domestic issuance principle). Recently, Prague has increased the share of foreign equities trading significantly. However, most exchanges in new Member States have around 100% domestic equity trading.

Figure (4) Share of Domestic Trading in % of total trading.



B. BIS data

The revenues for foreign exchange (FX or Forex) markets and OTC derivatives were estimated using the data from the Bank for International Settlement (BIS). More specifically, all the figures for the FX and OTC markets are taken from the annual report by the Triennial Central Bank Survey (covering the years 2010, 2007, 2004 and 2001). The survey collects data from central banks and monetary authorities from all BIS members analysed.

In the statistics used the total foreign exchange markets turnover covers such instruments as: spot transactions, outright forwards, foreign exchange swaps, currency swaps and options. Furthermore, the turnover is defined as the absolute gross value of all new deals entered into during the month of April 2010/2007/2004/2001, and is measured in terms of nominal or notional amount of the contracts. In addition, transactions were reported to the BIS in US dollar equivalents, with non-dollar amounts converted into US dollars using the exchange rate prevailing on the date of the trade; in statistical tables the turnover is presented as a daily average. Finally, for turnover data, the basis for reporting was the location of the sales desk of any trade, even if deals entered into in different locations were booked in a central location.

In the turnover part, the instrument breakdown distinguishes between spot transactions, forwards, swaps, options and other foreign exchange products. The counterparty breakdown distinguishes between transactions with reporting dealers, with other financial institutions and with non-financial customers. Moreover, the currency breakdown includes separate reporting of all reporting countries' currencies, while the maturity breakdown distinguishes between

transactions with original maturity up to seven days, over seven days and up to one year, and over one year. As in the turnover part of the survey, data for the OTC foreign exchange instruments are broken down by counterparty, currency, and instruments (FRAs, swaps, and options).

List of statistical tables used:

- Global foreign exchange market turnover by instrument, counterparty and maturity
- Global foreign exchange market turnover by currency pair
- Global OTC interest rate market turnover by instrument, counterparty
- Global OTC interest rate derivatives turnover by currency
- Geographical distribution of global foreign exchange market turnover
- Geographical distribution of global interest rate derivatives turnover
- Foreign exchange turnover/ Spot foreign exchange turnover/ Outright forward foreign exchange turnover/ Foreign exchange swap turnover/ Currency swap turnover/ Options turnover by country

With regard to derivatives, it should be noted that it is important to separate turnover data from data on notional amounts outstanding. The BIS gathers statistics from the central banks of its members. For the second half of 2009 an amount of USD 349 billion was reported in notional amounts outstanding in interest rate swaps. These figures seem extremely high at first glance. However, it is important to understand that this is the total stock or inventory of interest rate swaps globally across all currencies and all maturities. This inventory has grown over years and does not represent turnover or activity in trading for a certain period. In fact, there are many swaps that actually extend out to 50 years and are listed in this inventory.

The BIS data on derivatives can be divided in two major categories:

1. Exchange-traded derivatives

Quarterly data on turnover and open interest measured in terms of both notional amounts (US dollars) and number of contracts. Data on notional amounts are only available for the main financial derivatives contracts, i.e. FX, IR, and equity index contracts. Note that for the single equity and the for commodity derivatives contracts only the data in terms of number of contracts is available (table 23B). http://www.bis.org/statistics/extderiv.htm

2. OTC derivatives

2a. Amounts outstanding (Semi-annual Survey)

Semi-annual data on amounts outstanding at end-June and at end-December, i.e. stocks measured in terms of gross notional and gross market values. These data are broken down by market risk category (FX, IR, equity linked, commodity and credit), instrument, counterparty, maturity, currency, etc.

- Statistical tables 19-22C: http://www.bis.org/statistics/derstats.htm
- Detailed tables: http://www.bis.org/statistics/derdetailed.htm

2b. Turnover (Triennial Survey)

Turnover data measured in terms of gross notional values and covering only FX and IR derivatives instruments, i.e. forwards, swaps and options. Note that all these aggregates are expressed in terms of daily averages.

- 2010: http://www.bis.org/publ/rpfxf10t.pdf#page=42
- 2007: http://www.bis.org/publ/rpfxf07a.pdf
- 2004: http://www.bis.org/publ/rpfx05a.pdf
- 2001: http://www.bis.org/publ/rpfx02a.pdf
- 1998: http://www.bis.org/publ/r_fx98statanx.pdf
- 1995: http://www.bis.org/publ/r_fx96.pdf

Table (3) summarizes the transactions volumes from the two data sources for 2010 and the large contribution from the derivative markets to the trading volume which is mainly based on the fact that the notional values is used as the measurement basis. Note that in the following it is implicitly assumed that the source principle is applied. The reason is that the current collection of transaction data follows is similar to the tax base according to the source principle.

Table (3): Volumes exchanged in Notional Amounts (2010) – EUR billions

Equity Trading	Bonds Trading	Exchange Traded derivatives	OTC derivatives	FX spot	FX Swaps	FX Outright forward	Sum
7,237.2	13,432.7	468,171.1	312,926.7	162,186.4	225,170.7	53,532.6	1,242,667

Source: FESE, BIS

2.3 Revenue estimates

Policy Option 1A: Currency Transaction Tax (CTT)

The revenue effects of a (global) Currency Transaction Tax have been studied extensively over the last years and there are numerous papers from different organisations and researchers on the potential revenue. As with all other transaction taxes, the figures should be interpreted

with caution due to the degree of uncertainty with regard to the behavioural effects. It should be noted that this option raises significant legal issues as explained in Annex 7.

A CTT would target currency conversions only; a levy based on this principle was recently proposed by the Committee of Experts to the Task Force on International Financial Transactions and Development. The report notes that the levy is - contrary to other proposals on FTT - not designed to change market behaviour as such. The study argues that the proposed very low rate of 0.005% would lead to only negligible effects on markets. It is designed as a pure revenue raiser. This is based on the CTT discussion in Schmidt (2008) who also presents an estimate for the potential CTT revenue. He finds that a tax rate of this size should not affect fundamental market behaviour. Using this tax rate (0.005%) with data on average spreads for different currencies until 2006 as well as BIS data on turnover in FX markets he finds that taxing the Euro against all other currencies could generate revenue of around 9 billion Euro in 2007 (0.07 % of GDP). If the tax is levied also on Pound Sterling this could raise an additional EUR 3.1 billion according to these estimates.[4]

Before presenting the results for the tax rate range considered here, the revenue potential of the proposal by the Committee of Experts to the Task Force on International Financial Transactions and Development (2010) is estimated. Levying a tax of 0.005% on FX spot market turnover within the EU-27 for 2010 (source principle) revenue estimates are around EUR 7 billion for 2010 assuming that fiscal evasion is only 5% given the very low tax rate. The elasticity is assumed to be -1. The transaction costs are chosen to be 0.024% which is in line with McCulloch and Pacillo (2011).

If a tax rate of 0.05% is applied the revenue increases to EUR 15.8 billion. Note that the assumed reduction of the tax base is lower compared to other estimates. The reason is that King and Rime (2010) show that the share of algorithmic trading in FX markets was 45%. In line with other authors we assume that this trading will largely disappear even at very low tax rates. Note that 80% of spot transactions take place in the UK. In line with Schmidt (2008) the estimates here consider only the spot market.

Table (3) Hypothetical revenue from taxing spot transactions, EU-27 in EUR b

FX Spot market

	Tax rate 0.1%				Tax rate 0.05%				Tax rate 0.01%			
Year	ε 0	ε -0.5	ε -1	ε -1.5	ε 0	ε -0.5	ε -1	ε -1.5	ε 0	ε -0.5	ε -1	ε -1.5
2001	39.2	17.3	7.6	3.3	19.6	11.2	6.4	3.6	3.9	3.3	2.8	2.3
2004	40.9	18.0	7.9	3.5	20.4	11.6	6.6	3.8	4.1	3.4	2.9	2.4
2007	52.4	23.0	10.1	4.5	26.2	14.9	8.5	4.8	5.2	4.4	3.7	3.1
2010	97.3	42.8	18.8	8.3	48.7	27.7	15.8	9.0	9.7	8.2	6.9	5.8

[4] Applying the approach taken by Schmidt to the EU-27 currency spot markets (i.e. the FX turnover by geographical distribution as reported by the BIS) a tax at this rate levied on spot markets would generate around EUR 7.2 billion in the EU-27. Note that the tax base chosen here is different since the transactions are based on where the currency trade took place while Schmidt (2008) looked at different currency pairs.

Assumption: Transaction Costs 0.024%, Relocation and Evasion 40%, Elasticity is ε.

Source: BIS and own calculations

The potential values for other derivative FX markets (Swaps and Outright forwards) are reported for information below in tables (4) and (5). The estimates have not been reported in the main text. The assumptions on relocation and evasion are the same as for other derivative markets.

Table (4) Hypothetical revenue from taxing FX swaps, EU-27 in EUR b

FX swaps												
	Tax rate 0.1%				Tax rate 0.05%				Tax rate 0.01%			
Year	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2
2001	13.7	2.6	1.2	0.5	6.8	2.2	1.3	0.7	1.4	1.0	0.8	0.7
2004	14.0	2.7	1.2	0.5	7.0	2.3	1.3	0.7	1.4	1.0	0.8	0.7
2007	23.3	4.5	2.0	0.9	11.6	3.8	2.2	1.2	2.3	1.6	1.4	1.2
2010	22.5	4.4	1.9	0.8	11.3	3.7	2.1	1.2	2.3	1.6	1.3	1.1

Assumption: Transaction Costs 0.024%, Relocation and Evasion 90%, Elasticity is ε.

Source: BIS and own calculations.

Table (5) Hypothetical revenue from taxing FX Outright Forwards, EU-27 in EUR b

FX Outright Forwards

	Tax rate 0.1%				Tax rate 0.05%				Tax rate 0.01%			
Year	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2
2001	2.1	0.4	0.2	0.1	1.1	0.3	0.2	0.1	0.2	0.2	0.1	0.1
2004	2.7	0.5	0.2	0.1	1.3	0.4	0.2	0.1	0.3	0.2	0.2	0.1
2007	3.5	0.7	0.3	0.1	1.8	0.6	0.3	0.2	0.4	0.3	0.2	0.2
2010	5.4	1.0	0.5	0.2	2.7	0.9	0.5	0.3	0.5	0.4	0.3	0.3

Assumption: Transaction Costs 0.024%, Relocation and Evasion 90%, Elasticity is ε.

Source: BIS and own calculations.

In summary, a currency transaction tax on spot transactions as proposed by the Committee of Experts to the Task Force on International Financial Transactions and Development (2010) could generate around EUR 7 billion per year in the EU-27 with a tax rate of 0.005% (not in the table). If the tax rate is increased to 0.05%, revenue estimates increase to EUR 27.7 billion.

Policy Option 1B: Securities Transaction without derivatives and currency transactions (STT with a narrow base)

This policy options corresponds to the "narrow-based" FTT as described in European Commission (2010f). The data for the equity calculations is based on figures available from the Federation of European Securities Exchanges (FESE). The data contain information on equity trades in regulated exchanges. There are no data on turnover on private exchanges like exchange systems of some large banks (for example Sigma X by Goldman Sachs) and on private placement of shares.

Unfortunately, equity trading in OTC markets is not covered in the FESE data. Assumptions about the share of the latter are disputed and vary widely. Reported values range from 16% to 38%.[5] If these OTC transactions were also part of the tax base, the revenues could increase accordingly. With regard to the elasticities the estimates rely on information from a study by Copenhagen Economics (2011) in Annex 9 on the tax elasticities of financial products. For equity the study report long-run elasticities of around 1.5 which is the baseline scenario chosen here. The estimates also show revenue estimates for elasticities smaller (1) and larger (2) than the baseline, as well as a scenario of inelasticity of the base (0). It should be noted that short-run elasticities are lower than the long-run elasticities. The estimates below do not

[5] afme (2011) reports a valu7e of 16 % while FESE (2011) estimates the value to be 38 %.

cover this dynamic effect which reduces the tax base over time. Table (6) shows the estimates for equity markets.

Table (6) Hypothetical revenue from taxing equity transactions for the EU-27 in EUR b

Revenue Equity Trading

	Tax rate 0.1%				Tax rate 0.05%				Tax rate 0.01%			
Year	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2
2000	11.2	9.6	8.9	8.3	5.6	5.2	5.0	4.8	1.1	1.1	1.1	1.1
2001	10.0	8.6	8.0	7.4	5.0	4.6	4.4	4.3	1.0	1.0	1.0	1.0
2002	8.6	7.4	6.8	6.3	4.3	4.0	3.8	3.7	0.9	0.8	0.8	0.8
2003	7.3	6.3	5.8	5.4	3.7	3.4	3.2	3.1	0.7	0.7	0.7	0.7
2004	8.9	7.6	7.1	6.5	4.4	4.1	3.9	3.8	0.9	0.9	0.9	0.9
2005	10.6	9.1	8.4	7.8	5.3	4.9	4.7	4.5	1.1	1.0	1.0	1.0
2006	13.8	11.8	11.0	10.2	6.9	6.4	6.1	5.9	1.4	1.4	1.3	1.3
2007	18.4	15.7	14.6	13.5	9.2	8.5	8.1	7.8	1.8	1.8	1.8	1.8
2008	13.1	11.3	10.4	9.6	6.6	6.1	5.8	5.6	1.3	1.3	1.3	1.3
2009	6.8	5.8	5.4	5.0	3.4	3.1	3.0	2.9	0.7	0.7	0.7	0.7
2010	6.5	5.6	5.2	4.8	3.3	3.0	2.9	2.8	0.7	0.6	0.6	0.6

Assumption for French Formula: Transaction Costs 0.6%, Fiscal Evasion 10%, Elasticity is ε.

Source: FESE and own calculations.

With regards to bond trading it should be noted that according to FESE only 5% of total bond trading is executed in exchanges. The biggest share of bonds, e.g. around 95% are traded in OTC markets. Assuming that these transactions would be fully taxable the revenue from bond trading would be significantly higher. There are no elasticities for fixed income securities but reactions in Sweden measured in semi-elasticities were dramatic: the introduction of a tax of 2 basis points triggered reductions in traded volumes ranging from 28-85% on fixed income securities. Nevertheless, for the purpose of this study the same elasticities as for equity trading are used since it is often argued that the Swedish example is not representative because of inadequate implementation of the tax. Table (7) shows the results of these estimates. Note that the data on bond trading are only fully available from 2003 onwards. For this reason tables (7) and (8) report only the values for the period from 2003 to 2010.

Table (7) Hypothetical revenue from taxing bond transactions for the EU-27 in EUR b

Revenue Bond Trading

	Tax rate 0.1%	Tax rate 0.05%	Tax rate 0.01%

Year	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2
2003	8.0	6.9	6.3	5.9	4.0	3.7	3.5	3.4	0.8	0.8	0.8	0.8
2004	7.3	6.2	5.8	5.3	3.6	3.3	3.2	3.1	0.7	0.7	0.7	0.7
2005	8.0	6.9	6.3	5.9	4.0	3.7	3.5	3.4	0.8	0.8	0.8	0.8
2006	8.6	7.4	6.8	6.3	4.3	4.0	3.8	3.7	0.9	0.8	0.8	0.8
2007	8.5	7.3	6.8	6.3	4.3	3.9	3.8	3.6	0.9	0.8	0.8	0.8
2008	10.4	8.9	8.2	7.6	5.2	4.8	4.6	4.4	1.0	1.0	1.0	1.0
2009	12.1	10.4	9.6	8.9	6.1	5.6	5.4	5.2	1.2	1.2	1.2	1.2
2010	12.1	10.4	9.6	8.9	6.0	5.6	5.4	5.2	1.2	1.2	1.2	1.2

Assumption for French Formula: Transaction Costs 0.6%, Relocation and Evasion 10%, Elasticity is ε.

Source: FESE and own calculations

The sum of the two revenue sources is displayed in table (8). The revenue figures are closely connected to the business cycle mainly because the values of assets increase in upturns and decreases in downswings.

Table (8) Hypothetical revenue from taxing bond and equity transactions for the EU-27 in EUR b

Total Revenue Equity and Bond Trading

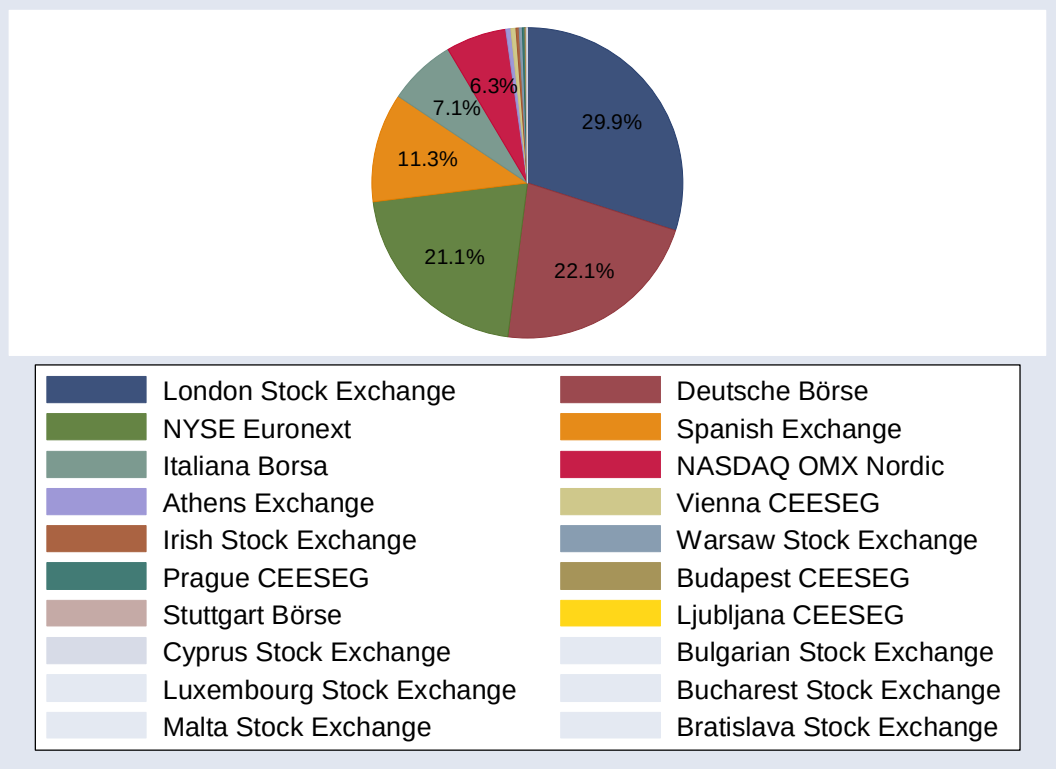
	Tax rate 0.1%				Tax rate 0.05%				Tax rate 0.01%			
Year	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2	ε 0	ε -1	ε -1.5	ε -2
2003	15.3	13.1	12.2	11.3	7.7	7.1	6.8	6.5	1.5	1.5	1.5	1.5
2004	16.2	13.8	12.8	11.9	8.1	7.5	7.2	6.9	1.6	1.6	1.6	1.6
2005	18.6	15.9	14.8	13.7	9.3	8.6	8.3	7.9	1.9	1.8	1.8	1.8
2006	22.4	19.2	17.8	16.5	11.2	10.3	9.9	9.5	2.2	2.2	2.2	2.2
2007	26.9	23.1	21.4	19.8	13.5	12.4	11.9	11.5	2.7	2.6	2.6	2.6
2008	23.5	20.2	18.7	17.3	11.8	10.9	10.4	10.0	2.4	2.3	2.3	2.3
2009	19.0	16.2	15.0	13.9	9.5	8.7	8.4	8.1	1.9	1.9	1.8	1.8
2010	18.6	15.9	14.8	13.7	9.3	8.6	8.2	7.9	1.9	1.8	1.8	1.8

Assumption: Transaction Costs 0.6%, Relocation and Evasion 10%, Elasticity is ε.

Source: FESE and own calculations.

In terms of GDP, the revenue in 2010 corresponds to 0.07% of GDP for a tax rate of 0.05% and an elasticity of 1.5 (baseline scenario marked in grey). The peak in terms of revenue was reached in 2007 reaching 0.10% of GDP. The tax revenue is distributed unevenly across countries. Figure (5) shows the shares in equity trading volumes for the EU exchanges in the dataset. The revenue from the taxation of equities would be distributed accordingly.

Figure (5) Share of EU-27 equity trading on regulated exchanges in 2008



Policy Option 1D: Financial Transaction Tax (FTT)

The main difference between policy option 1c and options 1a and 1b is the inclusion of derivatives in the tax base.[6] The assumptions about reaction of derivative markets are also the main difference between recent revenue estimates discussed in the popular debate and the approach taken by the Commission in recent publications, notably the Staff Working Documents "Innovative Finance at global level" (European Commission (2010e)) and "Taxation of the Financial Sector" (European Commission (2010f)) no estimates for these markets were given.

This document here will also take a very cautious approach to the estimation of revenue from derivative transactions based on the notional value. The assumption is that large parts of the markets as well as the resulting tax base will largely disappear. The reason for this rather conservative approach is the high degree of uncertainty with regard to the taxation of derivatives based on notional values. Note that this does not mean that such a tax would not

[6] Note that policy option 1C (taxation of derivatives only) presented in the main document is not explicitly modelled here but part of option 1D.

be feasible at all. On the contrary, section 5 has explicitly mentioned the notional value as preferred tax base despite the expected reactions. The main reason is that the notional is easy to observe. In addition to this, the CTT part of the FTT raises significant legal issued which need to be addressed. Taken together, the expected effects on these market segments are such that revenue estimates used as a basis for an informed policy decision should highlight the uncertainties with regard to potential revenues.

An alternative would be to use differentiated tax rates for these products as proposed by Pollin et al. (2002) and discussed in section 5.2.3.2. The reason this avenue is not taken here is that differentiated tax rates would create other problems notably with regard to substitution and evasion effects. In summary, the main difference between the studies by Schulmeister (2011) and McCulloch and Pacillo (2011) and the approach taken here is the assumption about the reaction of derivative markets. In order to show the large variety of hypothetical revenue

The following arguments should be borne in mind when revenue estimates are used in evaluating the costs and benefits of taxing derivatives:

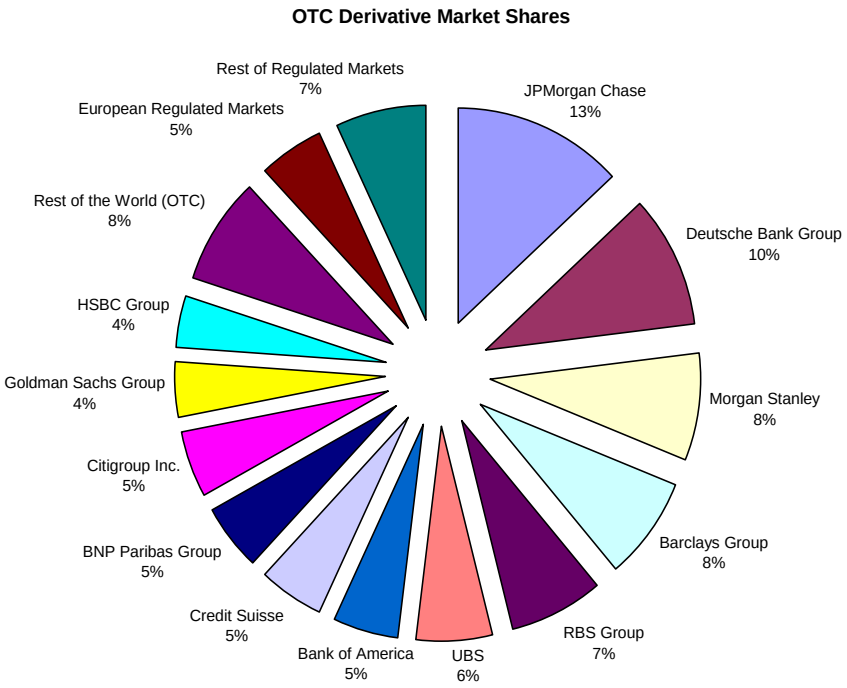
(1) The notional value is not a measure of the economic value of contracts

The turnover in terms of notional values and the notional amounts outstanding reported by the Bank for International Settlement (BIS) are proxies to measure the market activity in OTC derivatives market. The sum of notional values can become bigger than GDP or other economic aggregates since the assets underlying the derivative contracts can be involved in more than one contract. Since the market value of a derivative depends on the price changes of the underlying in the spot market it is constantly changing. The notional value is therefore used as an educated guess about the activity in these markets in the absence of better data. However, this does not imply that the economic activity behind these contracts is as big as the notional or underlying values. In fact, the BIS data show for 2004 and 2007 that the gross market value of the contracts is only a small fraction of the notional. In 2004, this share was 2.9%. In 2007, the gross market value accounted only for 2.5% of the notional values outstanding. A tax levied on the notional seems to target a very large tax base. But when this base is put into perspective with the economic values it is significantly smaller. Given this large difference it is reasonable to expect that the market size could shrink dramatically and the tax base accordingly.

In addition, the taxation of the notional will create high effective tax burdens. The argument is related to the one above: the notional value does not contain a large amount of economic information. An example for taxing the notional value of a derivative is the following. An EU-based company has to pay a bill of USD 11million in 3 months and fears a devaluation of the Euro. The company wants to hedge the risk that the Euro falls below USD 1.10. It acquires an option to buy USD at an exchange rate of 1.10 USD per Euro in 3 months. The price for this option is EUR 30,000. The value of the underlying is USD 11 million = EUR 10 million EUR. Assuming a very low tax rate of 0.01%, the tax payment would be EUR 1,000. Now compare the tax payment (EUR 1,000) to the price (EUR 30,000). If we define the tax payment in relation to the real cash-flow of buying the option as an effective tax rate, the effective rate is 3.3% in this example. Now assume that the company wants to hedge the extreme case that the Euro drops below parity with the USD. The price would be only 5,000 EUR in this case given the low risk that this case will occur in the next three month. In this case, the tax base is USD 11 million = EUR 11 million. The tax payment would be EUR

1,100. This leads to an effective tax rate of 22% when relating the tax paid with the actual price paid. For the taxation of derivatives, the effective tax rate as defined above will therefore be different and depend on the characteristics of the contract.

Figure (6) Shares of different actors in OTC derivative markets



Source: FESE

(2) The market for OTC derivatives is global and highly mobile

The OTC market is dominated by a dozen large global banks mainly based in London. Most of these banks are headquartered in the US; all of them are active on a global scale. Figure (6) illustrates the market shares in OTC derivatives markets as well as the main players. This market is fully globalized and, while there might be new regulations in the future to trace OTC transactions within the EU, the application of the tax in this highly mobile market will be difficult and reduce the taxable base significantly. Note that the question here is not whether such derivatives are useful for the economy and whether their disappearance would hurt the European economy. The point made here is that the tax base could largely disappear leaving no substantial revenue, but rather high uncertainty with regard to the economic effects.

(3) The data basis and netting effects

The data provided by the BIS does not account for the fact that many derivative contracts cancel out economically. A tax on the notional value will lead to the netting of contracts. This netted value of contracts is expected to be as low as a few percentage points for some market

segments. This is not necessarily a negative effect but again will reduce the tax base significantly. This highlights in addition to the arguments in 1. and 2. that the notional value cannot be considered as a stable tax base to finance government revenue.

(4) Empirical Evidence

The transaction tax experience from Sweden shows that derivative markets are very sensitive to taxation. Sweden levied a tax on transaction also for some fixed-income securities and related derivatives, notably futures on bonds. The rates were between 0.002% and 0.015% and therefore within the range of currently discussed tax rates. The trading in futures on bonds fell by 98% within the first week of the application of the tax.[7]

(5) Structural break

Some recent estimations assume that trading volumes in derivative markets decreases smoothly (monotonically) with the tax rate. While this assumption seems reasonable for spot market trades, the reactions in other market segments might be different. The reasons are the different micro-market structures in different segments. Given that taxing the notional creates a high tax leverage compared to the real cash flows it can be assumed that the reaction in the market is not only a reduction of the activity concerned but rather a change in the way business is conducted. The way such a structural break could take form is described by Honohan and Yoder (2010) for FX markets. They argue that the mechanisms of risk sharing in this market could change due to strong transaction cost increases. For example, King and Rime (2010) show that the transaction costs (the bid-ask spread) for the EUR/USD pair is currently one pip (0.0001). Applying a tax of, say 0.01% would represent a multiple of this margin. This could reduce the taxable base more than one would expect from a simple (linear or exponential) decrease of current trade volumes due to structural effects.

(6) Conflict with regulation

One objective of current regulation is to shift more transactions into central clearing platforms. At the same time there is consensus that this will not be possible for all forms of contracts since central platforms can only work for contracts with a certain degree of standardization. If a tax is levied in central systems, the incentive to standardize products and move to the CCP is reduced. This could hamper the regulatory goals envisaged.

In summary, the inclusion of the notional value of derivatives in the tax base creates a high degree of uncertainty with regard to the FTT. The notional value has so far been used for estimates mostly because it is the only data available for derivatives since it is easier to observe compared to other values in derivatives contracts. However, the notional value is not a measure of the economic value, the contracts under consideration or the risk exposure related to the contracts. For this reason the estimates for OTC interest rate derivatives as well as for exchange traded derivatives make the assumption that trade volumes decline by 90% due to evasion, netting, structural breaks and the fact that economic values behind these values are only a fraction of the notional amount – which is defined as the base for taxation. This assumption is larger than Schulmeister (2011) assumed a 60% to 70% decline in volumes of derivative contracts in a scenario with medium market reactions. In order to present the wide range of current estimates two summary tables with revenue figures for the

[7] See Campbell and Froot (1994) for a full description of the Swedish and other country experiences.

year 2010 are presented below. One table (11a) (scenario 1) assumes a reduction in derivative trading of 90%, the second table (11b) (scenario 2) a decline of 70%.

Before turning to the summary tables, the two derivative markets segments (exchange traded and OTC) are presented using the assumptions underlying scenario 1. For exchange traded derivatives table (9) below gives some revenue estimates for exchange traded derivatives, notably Single Stock Futures, Stock Index Options, Stock Index Futures, Bond Options and Bond Futures. The by far largest share of these instruments is traded in EURONEXT LIFFE, e.g. 95% of the Bond Future Trading took place here in 2008. The baseline scenario is marked in grey in table (9).

Table (9): Hypothetical revenue from taxing exchange traded derivatives turnover for EU-27 in billion EUR

Total Revenue Derivative Trading in Exchanges

	Tax rate 0.1%				Tax rate 0.05%				Tax rate 0.01%			
Year	ε 0	ε 1	ε 1.5	ε 2	ε 0	ε 1	ε 1.5	ε 2	ε 0	ε 1	ε 1.5	ε 2
2000	3.8	3.7	2.5	2.2	1.9	1.6	1.5	1.4	0.4	0.4	0.4	0.4
2001	5.3	5.1	3.4	3.0	2.6	2.3	2.1	1.9	0.5	0.5	0.5	0.5
2002	5.8	5.6	3.7	3.2	2.9	2.5	2.3	2.1	0.6	0.6	0.5	0.5
2003	32.5	31.4	21.1	18.3	16.2	13.9	12.9	11.9	3.2	3.1	3.1	3.0
2004	36.0	34.8	23.4	20.2	18.0	15.4	14.3	13.2	3.6	3.5	3.4	3.4
2005	39.9	38.6	25.9	22.4	20.0	17.1	15.8	14.7	4.0	3.9	3.8	3.7
2006	47.3	45.8	30.8	26.6	23.7	20.3	18.8	17.4	4.7	4.6	4.5	4.4
2007	58.3	56.4	37.9	32.8	29.1	25.0	23.1	21.4	5.8	5.6	5.6	5.5
2008	56.4	54.6	36.7	31.7	28.2	24.2	22.4	20.7	5.6	5.5	5.4	5.3
2009	49.3	47.7	32.0	27.7	24.6	21.1	19.6	18.1	4.9	4.8	4.7	4.6
2010	46.8	45.3	30.4	26.3	23.4	20.1	18.6	17.2	4.7	4.5	4.5	4.4

Assumption: Transaction Costs 0.3%, Relocation and Evasion 90%, Elasticity is ε.

Source: FESE and own calculations.

For OTC market the estimates concentrate on the largest product group namely interest rate derivatives for which turnover in notional values are collected by the BIS every three years. The data contains Forward Rate Agreements, Swaps, and Options and other products. The data is taken from BIS (2010) Again the assumption is a stronger reaction of markets compared to the studies mentioned above due to the expectation that a tax of this size will have structural effects on markets.

Table (10): Hypothetical revenue from taxing OTC interest rate contracts in EU-27 in EUR b

OTC interest rate derivatives

	Tax rate 0.1%				Tax rate 0.05%				Tax rate 0.01%			
Year	ε 0	ε 1	ε 1.5	ε 2	ε 0	ε 1	ε 1.5	ε 2	ε 0	ε 1	ε 1.5	ε 2
2001	14.1	12.3	11.5	10.8	7.0	6.6	6.3	6.1	1.4	1.4	1.4	1.4
2004	18.3	16.0	15.0	14.0	9.2	8.5	8.3	8.0	1.8	1.8	1.8	1.8
2007	24.9	21.8	20.4	19.1	12.4	11.6	11.2	10.8	2.5	2.5	2.4	2.4
2010	31.3	27.4	25.6	24.0	15.6	14.6	14.1	13.6	3.1	3.1	3.1	3.0

Assumption: Transaction Costs 0.7%, Fiscal Evasion 90%, Elasticity is ε.

Source: BIS and own calculations.

In summary, the revenue estimates for a general FTT as well as for its subsets can raise significant amounts of revenue. The difficulties in interpreting these figures have been outlined above. Market reactions are highly uncertain and taxing derivatives might create strong incentives. Also, the revenue generated has to be put into perspective with the loss in GDP from taxation. The revenue figures for 2010 for policy option 1 are summarized in table 11a (Scenario 1) and table 11b (Scenario 2). The tables show that depending on which assumption is chosen for tax rates, revenue and evasion and relocation revenue figures between EUR 16.4 billion (90% reduction, elasticity of 2) to more than EUR 400 billion (70% reduction, elasticity of 0) can be generated with the underlying data. The baseline with a tax rate of 0.05% and an elasticity of 1.5 generates EUR 59 billion (or 0.48% of GDP) in scenario 1 and EUR 130 billion (1.06% of GDP) in scenario 2.

Table (11a): Hypothetical revenue from taxing transactions and contracts, EU-27 in EUR b for 2010, scenario 1 assuming 90% decrease in derivative trading.

Elasticity 0	Tax rate 0.1		Tax rate 0.05		Tax rate 0.01%	
	Revenue	% of GDP	Revenue	% of GDP	Revenue	% of GDP
CTT	125.2	1.02%	62.6	0.51%	12.5	0.10%
STT equity and bond	18.6	0.15%	9.3	0.08%	1.9	0.02%
OTC Interest Rate Derivatives	31.3	0.26%	15.6	0.13%	3.1	0.03%
Exchanges Derivatives	46.8	0.38%	23.4	0.19%	4.7	0.04%
FTT (Sum of all revenues)	221.9	1.81%	110.9	0.91%	22.2	0.18%
FTT (without CTT)	96.7	0.79%	48.4	0.39%	9.7	0.08%

Elasticity 1	Tax rate 0.1		Tax rate 0.05		Tax rate 0.01%	
	Revenue	% of GDP	Revenue	% of GDP	Revenue	% of GDP
CTT*	48.2	0.39%	32.2	0.26%	10.1	0.08%
STT equity and bond	15.9	0.13%	8.6	0.07%	1.8	0.01%
OTC Interest Rate Derivatives	27.4	0.22%	14.6	0.12%	3.1	0.03%
Exchanges Derivatives	45.3	0.37%	20.1	0.16%	4.5	0.04%
FTT (Sum of all revenues)	136.8	1.12%	75.5	0.62%	19.6	0.16%
FTT (without CTT)	88.6	0.72%	43.3	0.35%	9.4	0.08%

Elasticity 1.5	Tax rate 0.1		Tax rate 0.05		Tax rate 0.01%	
	Revenue	% of GDP	Revenue	% of GDP	Revenue	% of GDP
CTT*	21.2	0.17%	18.4	0.15%	8.5	0.07%
STT equity and bond	14.8	0.12%	8.2	0.07%	1.8	0.01%
OTC Interest Rate Derivatives	25.6	0.21%	14.1	0.12%	3.1	0.03%
Exchanges Derivatives	30.4	0.25%	18.6	0.15%	4.5	0.04%
FTT (Sum of all revenues)	92.0	0.75%	59.3	0.48%	17.9	0.15%
FTT (without CTT)	70.8	0.58%	40.9	0.33%	9.3	0.08%

Elasticity 2	Tax rate 0.1		Tax rate 0.05		Tax rate 0.01%	
	Revenue	% of GDP	Revenue	% of GDP	Revenue	% of GDP
CTT*	9.3	0.08%	10.5	0.09%	7.2	0.06%
STT equity and bond	13.7	0.11%	7.9	0.06%	1.8	0.01%
OTC Interest Rate Derivatives	24.0	0.20%	13.6	0.11%	3.0	0.02%
Exchanges Derivatives	26.3	0.22%	17.2	0.14%	4.4	0.04%
FTT (Sum of all revenues)	73.3	0.60%	49.2	0.40%	16.4	0.13%
FTT (without CTT)	64.0	0.52%	38.8	0.32%	9.2	0.08%

** Elasticities on FX spot markets are assumed to be 0.5 lower compared to other options in line with the findings in Annex 9 on tax elasticities.*

Note that the CTT raises legal issues. The FTT revenue is also reported without the CTT.

Table (11b): Hypothetical revenue from taxing transactions and contracts, EU-27 in EUR b for 2010, scenario 2 assuming 70% decrease in derivative trading.

Elasticity 0	Tax rate 0.1		Tax rate 0.05		Tax rate 0.01%	
	Revenue	% of GDP	Revenue	% of GDP	Revenue	% of GDP
CTT	180.9	1.48%	90.5	0.74%	18.1	0.15%
STT equity and bond	18.6	0.15%	9.3	0.08%	1.9	0.02%
OTC Interest Rate Derivatives	93.9	0.77%	46.9	0.38%	9.4	0.08%
Exchanges Derivatives	140.5	1.15%	70.2	0.57%	14.0	0.11%
FTT (Sum of all revenues)	433.9	3.54%	216.9	1.77%	43.4	0.35%
FTT (without CTT)	252.9	2.07%	126.5	1.03%	25.3	0.21%

Elasticity 1	Tax rate 0.1		Tax rate 0.05		Tax rate 0.01%	
	Revenue	% of GDP	Revenue	% of GDP	Revenue	% of GDP
CTT*	59.0	0.48%	41.3	0.34%	14.1	0.11%
STT equity and bond	15.9	0.13%	8.6	0.07%	1.8	0.01%
OTC Interest Rate Derivatives	82.1	0.67%	43.8	0.36%	9.3	0.08%
Exchanges Derivatives	135.9	1.11%	60.2	0.49%	13.6	0.11%
FTT (Sum of all revenues)	293.0	2.39%	153.9	1.26%	38.8	0.32%
FTT (without CTT)	234.0	1.91%	112.6	0.92%	24.7	0.20%

Elasticity 1.5	Tax rate 0.1		Tax rate 0.05		Tax rate 0.01%	
	Revenue	% of GDP	Revenue	% of GDP	Revenue	% of GDP
CTT*	26.0	0.21%	23.5	0.19%	11.8	0.10%
STT equity and bond	14.8	0.12%	8.2	0.07%	1.8	0.01%
OTC Interest Rate Derivatives	76.8	0.63%	42.3	0.35%	9.2	0.08%
Exchanges Derivatives	91.2	0.74%	55.7	0.46%	13.4	0.11%
FTT (Sum of all revenues)	208.8	1.70%	129.8	1.06%	36.2	0.30%
FTT (without CTT)	182.8	1.49%	106.3	0.87%	24.4	0.20%

Elasticity 2	Tax rate 0.1		Tax rate 0.05		Tax rate 0.01%	
	Revenue	% of GDP	Revenue	% of GDP	Revenue	% of GDP
CTT*	11.4	0.09%	13.4	0.11%	9.9	0.08%
STT equity and bond	13.7	0.11%	7.9	0.06%	1.8	0.01%
OTC Interest Rate Derivatives	71.9	0.59%	40.9	0.33%	9.1	0.07%
Exchanges Derivatives	79.0	0.65%	51.6	0.42%	13.2	0.11%
FTT (Sum of all revenues)	176.0	1.44%	113.8	0.93%	34.0	0.28%
FTT (without CTT)	164.5	1.34%	100.4	0.82%	24.1	0.20%

** Elasticities on FX spot markets are assumed to be 0.5 lower compared to other options in line with the findings in Annex 9 on tax elasticities.*

Note that the CTT raises legal issues. The FTT revenue is also reported without the CTT.

2.4 Further tax base considerations

(a) Share of transactions within the financial sector.

A possible policy proposal would be to exempt transactions by non-financial actors. The share of these transactions is difficult to estimate with precision.

The Bank for International Settlement (BIS) data splits transactions volumes between three categories: (a) "reporting dealers" are institutions that are actively buying and selling currency and OTC derivatives both for their own account and/or to meet customer demand, (b) “Other financial institutions” are defined as those financial institutions that are not classified as reporting dealers. Thus, they mainly cover all other financial institutions, such as smaller commercial banks, investment banks and securities houses, and in addition mutual funds, pension funds, hedge funds, currency funds, money market funds, building societies, leasing companies, insurance companies, financial subsidiaries of corporate firms and central banks, and (c) “Non-financial customers” are defined as any counterparty other than those described above, i.e. mainly non-financial end users, such as corporations and governments.

The reporting population of the Triennial Survey is constituted by the so called "reporting dealers", i.e. banks and securities houses that participate in the Survey. Therefore, if the bank

is a reporting dealer (i.e. it belongs to the reporting population of the Survey) any transaction carried out by this bank will be captured by the Survey and allocated to the appropriate counterparty category:

1) With reporting dealers: if the counterparty is another participating institution. These deals will be divided by 2 in order to correct for inter-dealer double-counting.

2) Other financial institutions: if the counterparty is a financial institution (banks, edge funds, etc) that does not participate in the Survey. In this case no adjustment for inter-dealer double-counting is needed, as these contracts are reported only once, i.e. by the reporting dealer.

3) Non-financial customers: If the counterpart is a non-financial customer, e.g. governments, corporations, etc.

The split only exists for two categories of products: (a) foreign exchange markets and (b) OTC interest rate markets. We consider only the last category of counterparty (i.e. non-financial customers). Its share in the total for foreign exchanges has varied over years between 13% (2010) and 18% (2007). Its share in OTC interest rate markets has varied between 5% (2001) and 11% (2010).

Given this variation, we make the assumption that globally the financial sector share is about 85% of the total volume.

(b) Primary versus secondary markets.

The size of primary market (i.e. securities issued for the first time) is estimated here to be 3.3% of the secondary market for shares and 1.6% of the secondary market for bonds.[8]

(c) Notional versus Gross Market Value.

[8] These figures are broad estimates. For shares, we refer to the World Bank data, comparing stock market turnover to GDP with equity issues to GDP. The data is for 1980-1995. For DE, the respective figures are 18% and 0.6% while for the US, they are 1% and 34% respectively. So, the ratio is about 3.3%. http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:20696167~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html
For bonds, we refer to data quoted in http://en.wikipedia.org/wiki/Bond_market . In this source, total outstanding amount (note, not trading) is USD 95 trillion while issuance is USD 1.5 trillion.

As indicated above, the economic value of derivative contracts is a few percentage points of their notional. Data for December 2010 is available and reveals that this share is about 3.7% for exchange-traded derivatives, 3.4% for OTC derivatives, 6.4% for currency swaps, and 3.1% for currency outright forward.[9]

(d) Netting

Currently, financial transactions are carried out using many intermediaries. For example, a private person that sells a financial asset may contact her bank, which in turn may contact an investment bank that will contact a broker. This broker may in turn contact another broker to whom it will sell the asset. This broker may sell it to an investment bank that will sell it to a commercial bank that will sell it to an interested private investor. This leads to many separate transactions. Would each transaction be subject to a financial transaction tax, there is an incentive to limit the number of them and to integrate intermediaries.

In addition, as stated above, many contracts also cancel out as there is a practice to close a contract simply by creating a new one that goes in the opposite direction.

These two examples are part of a process that is called the netting. While there are no official data, the netted value of contracts is expected to be as low as a few percentage points for some market segments

(e) High-Frequency Trading.

The share of high frequency trading is estimated to be between 20 to 40% of the total, depending on financial markets.[10]

(f) Government bonds.

[9] BIS Quarterly Review June 2011, table 19 for notional amounts outstanding/market values, the share of each category in December 2010 on total without foreign exchange contracts

[10] AFM, 2010, Authority For the Financial Markets, High frequency trading: The application of advanced trading technology in the European marketplace.
http://www.afm.nl/layouts/afm/default.aspx~/media/files/rapport/2010/hft-report-engels.ashx
See also Peter Gomber, Björn Arndt, Marco Lutat, Tim Uhle (2011), High Frequency Trading, http://ssrn.com/abstract=1858626

The share of government bonds in the total trading of bonds can be estimated at 42.5%. This is computed in the following way: (a) we assume that the share of government bonds in the total trading is equivalent to its share in stocks expressed in outstanding amounts.[11] We therefore use BIS data on Securities Markets and look at the ratios of government debt to the total for domestic and international debt securities[12]. They are respectively 55.8% and 11.5%. (b) Next, the international debt market represents 30% of the total.[13]

Hence the share of government bonds into the total is estimated at 0.3*11.5 + 0.7*55.8 = 42.5%.

3 THE ESTIMATES FOR REVENUES FROM FAT

Because the Financial Activities Tax is a relatively recent proposal, the only estimations of its potential revenues so far were the one done by the IMF (2010) and its extrapolation to the EU27 in the Commission's staff working document of October 2010. The IMF (2010) looked at the potential tax base in percentage of GDP for 22 OECD countries (of which 15 Member States) and for the 3 types of FAT. The IMF's computations used the aggregate national account data for the financial sector of OECD countries for the year 2006. FAT1 is defined as a R+F cash-flow base (as gross operating profits less gross fixed capital outlays in the financial intermediation sector) and wage costs (labour costs in the financial intermediation sector). For FAT2, the 'surplus' wage is set as 12% of total wage costs[14]. For FAT3, the profit part is the excess of after-tax net income in the banking sector over benchmark return on equity (ROE) of 15 percent.

The Staff Working Document of the European Commission extrapolated the tax base from the 15 Member States to the EU27 by applying the GDP-weighted average tax base in percentage of GDP to the missing Member States[15]. Applying a low FAT rate of 5% (corresponding to the minimum reduced VAT rate) and extrapolating the results from the sample of 15 Member States collected by the IMF (2010) – and representing 91% of EU27 GDP – to the EU27 for the three methods provides broad orders or magnitude for static tax revenues of respectively EUR 25.9 billion, EUR 11.1 billion and EUR 4.9 billion for 2008. These estimates are static in the sense that they do not include the tax elasticity of the FAT base.

[11] Clearly, this assumption has to be made because of a lack of reliable data on trading volumes per category of products. It is possible that government bonds are less frequently exchanged than other products in which case its share in trading would be overestimated.

[12] BIS (2011). BIS Quarterly Review, June 2011. Annex pages A111 and followings. Tables 12A, 12D, and 16A.

[13] The City UK (2011). Bond Markets. Financial markets Series, July 2011, page 1.

[14] Calculated as 40% of the wage differential between the top 25% earners in the financial sector and the top 25% in the wider economy.

[15] The sample's GDP-weighted average is 4.14% of GDP. For the Rent-taxing FAT and the Risk-taxing FAT, the GDP-weighted average would be 1.78% and 0.79% of GDP.

Table (12): Revenue estimates for the various forms of FAT (based on 2008 GDPs), tax rate 5%

Country	Addition method FAT			Rent-taxing FAT			Risk-taxing FAT		
	Tax base % GDP	Tax revenue % GDP	Tax revenue m EUR	Tax base % GDP	Tax revenue % GDP	Tax revenue m EUR	Tax base % GDP	Tax revenue % GDP	Tax revenue m EUR
BE	4.2	0.2	724	1.8	0.1	310	1.5	0.1	259
BG	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
CZ	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
DK	4.0	0.2	466	1.8	0.1	210	0.7	0.0	82
DE	3.6	0.2	4,492	1.5	0.1	1,872	0.5	0.0	624
EE	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
IE	8.4	0.4	764	5.7	0.3	518	1.8	0.1	164
EL	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
ES	3.5	0.2	1,905	1.7	0.1	925	0.9	0.0	490
FR	3.3	0.2	3,215	0.9	0.0	877	0.8	0.0	779
IT	3.6	0.2	2,822	1.6	0.1	1,254	0.4	0.0	314
CY	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
LV	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
LT	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
LU	23.2	1.2	456	15.3	0.8	301	5.7	0.3	112
HU	3.6	0.2	190	2.0	0.1	106	0.9	0.0	47
MT	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
NL	4.9	0.2	1,460	2.0	0.1	596	0.6	0.0	179
OE	4.0	0.2	564	1.7	0.1	240	1.8	0.1	254
PL	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
PT	4.8	0.2	413	2.6	0.1	223	0.5	0.0	43
RO	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
SI	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
SK	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
FI	1.9	0.1	175	0.9.	0.0	83	0.2	0.0	18
SE	2.5	0.1	418	0.9	0.0	150	0.7	0.0	117
UK	6.1	0.3	5,537	2.7	0.1	2,451	1.1	0.1	998
Sample	4.14	0.21	23,600.9	1.78	0.09	10,116,1	0.79	0.04	4,479.4
EU27			25,920.7			11,110.5			4,919.7

Source: IMF (2010), Financial Sector taxation. The IMF's Report to the G-20 and background material. Editors: S. Claessens, M. Keen and C. Pazarbasioglu. and own calculations. The estimates assume no behavioural response. For the rent-taxing and the risk-taxing FAT, the IMF takes 40% of the wage differential between the top 25% earners in the financial sector and the top 25% earners in other sectors. This 'surplus' is 12% of wage costs. For the risk-taxing FAT, the benchmark for the return on average

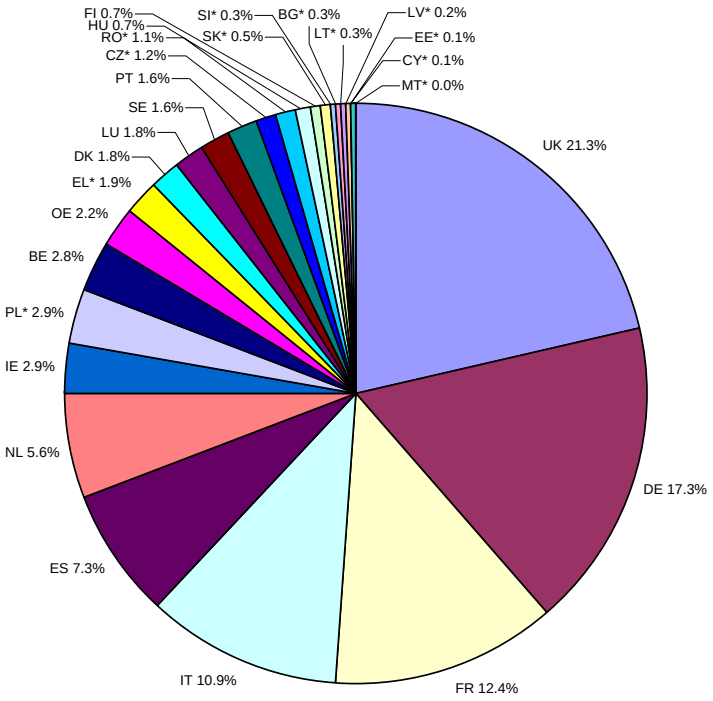
equity above which profit would be taxed is 15%. See IMF (2010) for other assumptions and details. Note that the IMF applies an R+F base by subtracting capital formation from profit. The EU27 figures are retrieved by taking the GDP-weighted average values of the sample for the tax base and applying them to EU-27 GDP for 2008.

For the 22 developed economies – representing about 62% of world GDP – considered in the IMF report to the G-20, a 5% rate of the addition-method FAT would create revenue corresponding to an arithmetic average of 0.28% of GDP.[16] Using the country level estimates for the share in GDP to calculate absolute figures, this would translate into total revenue for the 22 countries of roughly EUR 75 billion for the addition-method FAT.[17]

In terms of their geographical distribution, the potential tax revenues would - by and large - mirror the share of Member States in the activities of the financial sector (which is more diversified than their share in trading places).

Figures (7), (8) and (9) respectively present the distribution for the addition-method, rent-taxing and risk-taxing FAT. For Member States for which data is missing in table (12) are assumed to raise tax revenues in percentage of GDP in the same proportion as the sample's GDP average. The sign (*) indicates the countries concerned.

Figure (7): Share in tax revenue of EU Member States (Addition-method FAT)



[16] IMF (2010). Financial Sector taxation. The IMF's Report to the G-20 and background material. Eds. S. Claessens, M. Keen and C. Pazarbasioglu.

[17] The revenue for other FAT versions would be EUR 35 billion for the rent-taxing FAT and EUR 10 billion for the risk-taxing FAT.

Figure (8): Share in tax revenue of EU Member States (Rent-taxing FAT)

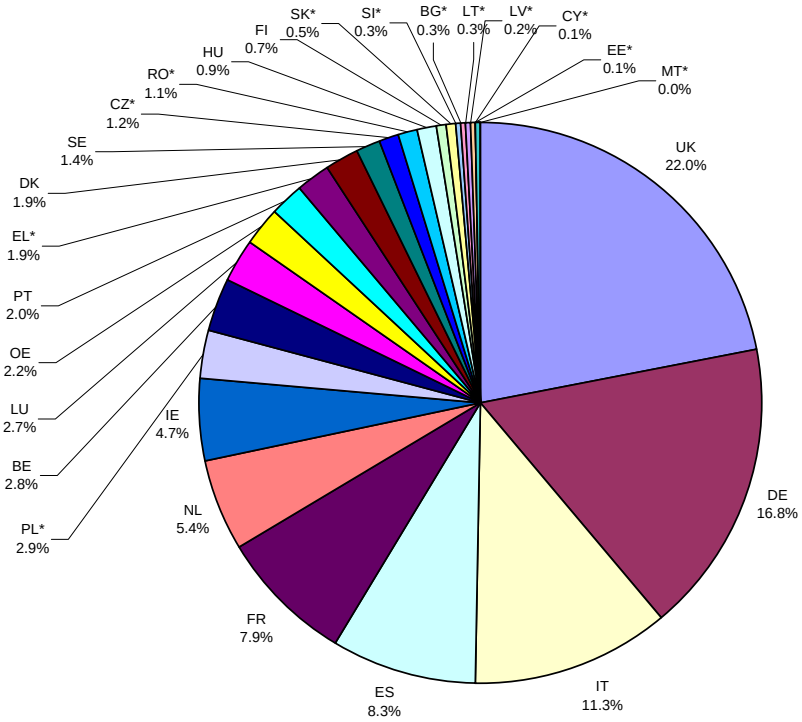
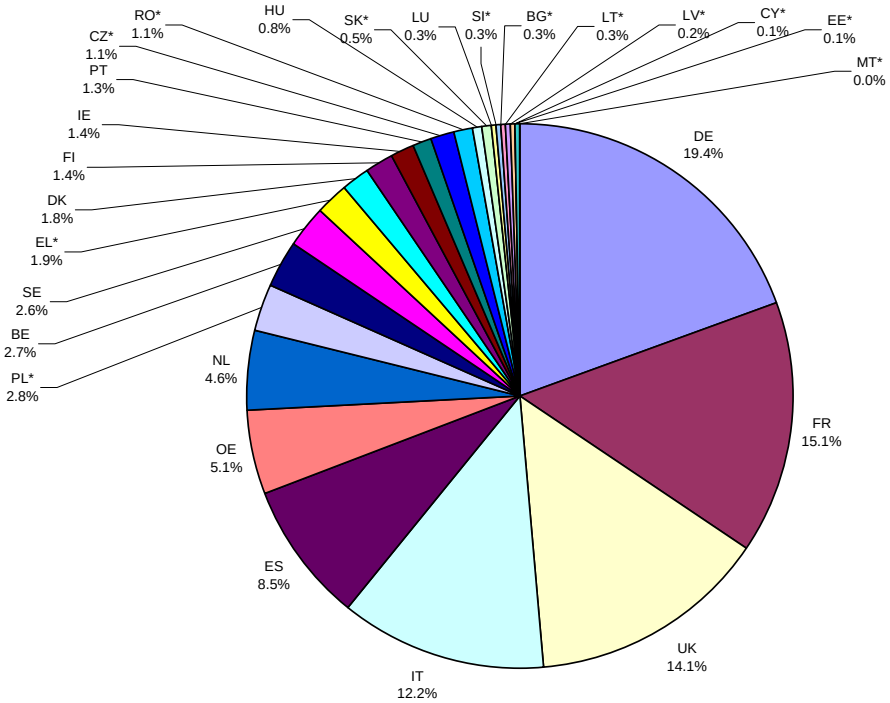


Figure (9): Share in tax revenue of EU Member States (Risk-taxing FAT)



An alternative method is to work from financial statements of the banking sector[18]. To achieve this, we take a sample of 3,008 banks in the EU for which enough financial information in an unconsolidated basis is available in ORBIS[19]. The profit part of the FAT base is computed as a R+F base by adapting accounting profit to cash-flow profit[20]. The labour costs part is the costs of personnel. As for the IMF's computation, the addition-method FAT is the sum of these two parts, the rent-taxing FAT takes the same cash-flow profit definition and 12% of labour costs and the risk-taxing part limits the cash-flow profit to what excesses 15% of total equity and adds it to 12% of the labour costs. It is important to note that the first two methods allow a loss-relief between the profit and the labour parts of the base, while the last method essentially put a ceiling of zero on the profit part. Hence, the base of a risk-taxing FAT could in theory be larger than the base for the other two methods.

In all cases, an illustrative rate of 5% is applied to the base for 2009 and the revenue estimates are extrapolated from the sample to the population of domestic banks[21.]

The results are presented in table (13). For several Member States, the estimates are based on a very small sample of domestic banks. Hence, the results shall be taken as illustrative and with due caution. Second, the data is for 2009, which may not be a representative year because of the effect of the financial crisis, which could underestimate the results22. Third, the sample can be biased toward larger banks, which could overestimate FAT2 and FAT3 in particular when extrapolating. Taking these caveats into account, the estimates for the addition-method FAT, the Rent-Taxing FAT and the Risk-Taxing FAT at a rate of 5% for EU27 are respectively EUR 30.3 billion, EUR 18.9 billion and EUR 13.6 billion.

[18] Hence, the results do not include other companies from the financial sector, notably insurance companies.

[19] Orbis is a database on financial statements of companies published by Bureau Van Dijk. Note that the sample can be biased towards large banks as financial information could be harder to obtain for smaller banks. Our version of Orbis contains 7,343 banks and 3,609 insurance companies for the EU27 (not of all with exploitable financial information). For many banks, several variables necessary to compute FAT revenues are missing. In this case, they are estimated in the following way: for companies for which consolidated statements are available in Orbis, the missing variable of interest is replaced by the one from the consolidated statements, adjusted by the ratio of total assets between unconsolidated and consolidated statements. If the information is still missing, the same procedure is applied using country-level information on banking structures from the ECB publication "EU Banking Sector Stability" of September 2010.

[20] This is done by starting with the profit and loss before tax and distribution, subtracting the dividends received from subsidiaries (i.e. applying an exemption to avoid double-taxation), adding the change in (non-equity) liabilities, subtracting the change in assets, except for change in cash hold and investment in subsidiaries.

[21] This is done by comparing the total assets of banks in the sample with the total assets of credit institutions in the country, excluding branches (from other EU and non-EU countries), as provided by ECB.

[22] The amount of data to be treated did not allow computation for other years. 2009 is the latest year with a mass of data that is exploitable.

Table (13). Estimates for a FAT in EU27 in 2009

Member State	Number of banks in sample	Coverage in assets	FAT1 base In % GDP	FAT1 revenue at 5% (EUR m)	FAT2 base In % GDP	FAT2 revenue at 5% (EUR m)	FAT3 base In % GDP	FAT3 revenue at 5% (EUR m)
AT	181	30.4%	4.4%	604.8	2.8%	378.0	1.9%	262.7
BE	24	82.3%	5.9%	1,000.5	4.1%	700.9	2.4%	406.1
BG	15	38.2%	2.8%	48.9	2.4%	42.0	1.7%	29.9
CY	6	41.7%	48.5%	410.6	42.4%	359.4	33.3%	282.2
CZ	13	20.7%	1.7%	119.4	1.3%	92.5	0.6%	40.9
DE	1,495	43.2%	5.3%	6,315.4	3.2%	3,821.0	2.4%	2,828.9
DK	99	70.8%	4.6%	513.2	2.3%	257.0	0.5%	53.3
EE	1	4.7%	2.0%	13.7	0.0%	0.0	0.3%	2.2
EL	15	65.2%	0.7%	78.2	0.1%	6.3	0.3%	36.2
ES	126	73.0%	3.0%	1,582.8	1.5%	799.0	0.9%	460.7
FI	9	78.4%	3.5%	298.3	2.6%	225.9	1.2%	101.9
FR	200	87.5%	6.2%	5,873.8	3.0%	2,903.9	1.9%	1,789.2
HU	11	10.1%	3.5%	163.8	3.1%	141.8	2.3%	105.7
IE	18	39.9%	1.0%	80.4	0.8%	66.9	0.6%	46.2
IT	468	81.4%	2.9%	2,186.7	0.6%	490.7	0.4%	332.4
LT	2	9.2%	0.7%	9.1	0.6%	8.3	0.7%	8.7
LU	55	65.3%	12.0%	229.2	9.8%	186.7	7.5%	143.4
LV	4	7.2%	0.5%	4.5	0.1%	1.1	0.1%	1.1
MT	10	43.8%	14.8%	43.1	10.4%	30.4	4.3%	12.6
NL	23	79.0%	11.0%	3,141.8	8.8%	2,524.3	8.0%	2,295.3
PL	24	12.1%	3.5%	549.2	2.6%	396.4	1.8%	280.6
PT	17	66.5%	1.1%	95.2	0.1%	4.4	0.3%	26.2
RO	11	21.4%	4.2%	247.1	3.9%	231.5	3.8%	222.0
SE	73	52.4%	0.6%	85.3	0.3%	40.7	0.3%	45.8

SI	8	21.6%	4.0%	69.9	3.0%	53.7	1.9%	32.8
SK	8	29.5%	0.2%	6.6	0.1%	3.3	0.1%	3.7
UK	92	58.1%	8.4%	6,538.2	6.6%	5,135.8	4.8%	3,719.1
EU27	3,008		5.1%	30,309.7	3.2%	18,901.7	2.3%	13,569.8

Source: Orbis and own calculations

This corresponds respectively to 0.26%, 0.16% and 0.12% of EU27 GDP and to 0.08%, 0.05% and 0.04% of the total assets of the EU banking sector. This is to be compared with the simulations using QUEST that find a revenue estimate of 0.21% of GDP for a 5% FAT (see annex 15).

Table (14): Evolution of FAT assuming a constant ratio of revenue to GDP (EUR billion)

	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
GDP	9,588	9,950	10,118	10,617	11,072	11,699	12,396	12,493	11,787	12,262
FAT1	24.7	25.6	26.0	27.3	28.5	30.1	31.9	32.1	30.3	31.5
FAT2	15.4	16.0	16.2	17.0	17.8	18.8	19.9	20.0	18.9	19.7
FAT3	11.0	11.5	11.6	12.2	12.7	13.5	14.3	14.4	13.6	14.1

**Estimates*

Interestingly, the FAT is a very good revenue raiser compared to the traditional CIT. The financial sector traditionally contributes to between 15% and 20% of total CIT collection (IMF, 2010, page 60). Total CIT collection in EU-27 in 2009 was EUR 228.3 billion (or 1.9% EU-27 GDP, coming from 342.1 billion in 2008 or 2.7% EU27 GDP). The share for the financial sector was therefore between EUR 34.2 billion and EUR 45.7 billion in 2009 (between EUR 51.3 billion and EUR 68.4 billion in 2008), to be compared with an estimated FAT1 collection of EUR 30.3 billion.

These estimates do not take into account a potential change in the base because of the FAT. The annex on the "Impact on Effective Tax Rates, the Cost of Capital, Interest Spreads and Capital Ratios" (See Annex 10) shall guide us to estimate this reaction. The estimated FAT here has a statutory rate of 5% (corresponding to a 3.75% EATR under specific hypothesis on return, inflation and interest rate). The tax can be seen as a tax on profit and remuneration of the sector. As a first estimate, on the profit part, the statutory rate of the FAT could be seen as an addition to the CIT. The average CIT statutory rate in 2010 in the EU27 is 23.2%. At one extreme, the FAT could therefore correspond to an increase in the rate on profit by 21.5% (i.e. 5/23.2). At the other extreme, the METR on the profit part of the FAT is zero, as shown in the above-mentioned annex.

In terms of elasticities, the review of the economic literature on "Tax Elasticities of Financial Instruments, Profits and Remuneration" by Copenhagen Economics (See Annex 9) provides (semi-)elasticities for reported profit, operating costs (including labour), profit shifting and location of financial companies to the statutory rate. To start with, the elasticity with regards to location is around -2 and the semi-elasticity is about -6. The elasticity with regards to operating costs is estimated at zero. This latter result means to the FAT would in theory have no effect on labour expenses. This seems also to be the effect reported in Denmark by Sørensen (2011). The elasticity of profit shifting is estimated at about 0.03 for domestic companies and -0.02 for foreign subsidiaries, although a recent study by IMF (2011) shows that the semi-elasticity of profit to assets to the statutory rate is between 6 and 8.5. One shall note however that all these (semi-)elasticities are estimated at country level and that a EU-level introduction of the tax would mean lower elasticities. They shall therefore be seen as upper bound.

Combined together, the various measures of the rates and the (semi-)elasticities allow drawing two scenarios. The optimistic scenario, based on the inelasticity of the labour part and a EMTR shown to be zero, is that the FAT will incur no reaction and that the static estimates are valid. The pessimistic scenario leads to a relocation of some subsidiaries of non-EU foreign financial companies by between 30% (semi-elasticity of -6 times a rate increase of 5 pp) and 43% (elasticity of -2 times the proportional increase in the rate of 21.5%). We assume here 40%. The relocation of foreign EU subsidiaries is more difficult to apprehend if the tax is introduced throughout Europe because the tax differential would be the same in absolute terms. Let's however take a pessimistic scenario of an arbitrary decrease in their assets by 5%. Based on ECB data[23], this corresponds for the EU27 in 2009 to a decrease in banks assets by 1.80% (from column (A) to (D)). Next, we apply a (high) semi-elasticity of 7 for reported profit of banks. This corresponds to a fall of 35% in the reported profit of remaining banks.

This would correspond to new revenues estimates for the FAT1, FAT2 and FAT3 of respectively EUR 24.6 billion, EUR 12.4 billion and EUR 9.3 billion for 2009. Again, these estimates assume very large effects on relocation and reported profit.

[23] ECB(2010), EU Banking Structures, September 2010, table 13.

Table (15): Estimates for a FAT in EU27 in 2009, with relocation and elasticities.

Member State (2009)	Assets from domestic credit inst., excl foreign branches but incl. foreign subs (EUR bn) (A)	Assets of subs from third countries (EUR bn) (B)	Assets of foreign subs from EU countries (EUR bn) (C)	Assets from domestic credit inst. After reloc (EUR bn) (A) -5%(B) -40%(C) =(D)	Of which purely domestic (EUR bn) (E)	FAT1 revenue at 5% after reloc and elast. (EUR Mio)	FAT2 revenue at 5% after reloc and elast. (EUR Mio)	FAT3 revenue at 5% after reloc and elast. (EUR Mio)
AT	1,025.7	48.7	141.6	999.2	835.5	479.5	248.7	182.7
BE	1,067.8	35.8	578.1	1,024.5	453.8	738.4	450.8	267.1
BG	36.3	0.8	29.3	34.5	6.2	33.4	26.2	19.2
CY	133.0	n.a.	45.5	130.7	87.5	282.3	232.0	182.7
CZ	141.5	n.a.	124.9	135.2	16.5	84.6	58.7	26.9
DE	7,241.7	53.1	563.2	7,192.4	6,625.5	5,213.6	2,561.2	1,968.7
DK	1,065.1	22.7	157.9	1,048.1	884.5	435.5	175.4	47.7
EE	15.8	0.0	14.7	15.0	1.1	14.7	0.0	2.1
EL	451.9	n.a.	65.2	448.6	386.7	105.9	4.3	34.6
ES	3,205.8	9.7	112.3	3,196.3	3,083.8	1,514.5	548.1	368.5
FI	370.7	0.0	243.2	358.6	127.6	215.4	145.4	67.7
FR	7,009.8	54.5	569.9	6,959.5	6,385.5	5,094.8	1,961.1	1,320.3
HU	118.3	n.a.	63.2	115.2	55.1	113.3	90.5	68.0
IE	1,198.3	90.4	445.1	1,139.9	662.9	94.6	42.0	39.0
IT	3,455.5	14.7	245.4	3,437.4	3,195.5	2,186.7	383.3	312.2
LT	21.6	0.0	17.2	20.7	4.4	6.0	5.2	5.7
LU	681.2	63.4	570.0	627.3	47.8	158.2	113.1	90.9
LV	26.3	1.8	15.1	24.8	9.3	5.5	0.7	1.1
MT	41.2	2.2	13.4	39.7	25.6	32.0	19.6	8.5
NL	2,153.2	41.0	14.0	2,136.8	2,099.0	2,351.6	1,649.3	1,526.4
PL	260.4	23.7	148.0	243.6	88.8	393.7	247.3	178.2

PT	486.9	4.8	82.1	480.9	400.0	133.1	3.4	25.9
RO	80.7	n.a.	60.0	77.7	20.8	161.9	145.6	141.2
SE	874.9	n.a.	4.4	874.6	870.5	100.4	27.8	44.4
SI	52.9	0.0	15.1	52.2	37.8	51.3	35.2	21.8
SK	50.7	0.0	48.6	48.3	2.1	5.5	2.2	3.2
UK	5,812.7	570.6	673.0	5,550.8	4,569.0	4,595.4	3,251.0	2,375.2
EU27	37,080.6	1,037.8	5,060.4	36,412.5	30,982.4	24,601.9	12,427.9	9,330.1

Source: ECB, Orbis and own calculations

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IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

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ANNEX 12

LEGAL AND ECONOMIC INCIDENCE

A necessary preliminary step in defining the impacts of a tax is the analysis of its incidence. While the legal incidence is on those who have the legal obligation to pay the tax, the concept of economic incidence refers to the person/groups who bear the economic burden of the tax. It is therefore informative on the changes in the distribution of welfare arising from the tax and, as such, plays a central role in the economic analysis of taxation.

In the case of the FAT and the balance sheet tax, the legal incidence is on the financial sector, with the precise institutional scope depending on the design of the tax instruments (see the description of the policy options in Chapter 5). The legal incidence of the FTT is less clear-cut, as it requires linking the taxable event to the liable entities. To this purpose, one would have to look at the trading activity of the different market participants in the markets for the relevant financial products. Only limited information is available on this.

Data on the turnover in the global **foreign exchange** market broken down by counterparty is available from the BIS[1]. The split is among "reporting dealers", "other financial institutions" and "non-financial customers"[2]. According to the December 2010 Triennial Central Bank Survey, in April 2010 almost half of the turnover in the foreign exchange market is accounted for by "other financial institutions", a category that includes non-reporting banks, hedge funds, pension funds, mutual funds, insurance companies and central banks. Also, the share of "reporting dealers" (mainly large commercial and investment banks) is three times as large as that of "non-financial customers", who account for roughly 13% of average daily turnover (see Table 12.1). Excluding the market for currency swaps – which accounts for a mere 1% of the global foreign exchange turnover – the participation of non financial customers ranges from 10% in the FX swaps market (44% of total turnover) to 23% in the outright forward

[1] BIS (2010), Triennial Central Bank Survey – Report on global foreign exchange market activity in 2010, December 2010.

[2] "Reporting dealers" are defined as those financial institutions that actively participate in local and global foreign exchange and derivatives markets. These are mainly large commercial and investment banks and securities houses that (1) participate in the interdealer market and/or (2) have active business with large customers, such as large corporate firms, governments and other non-reporting financial institutions. In other words, reporting dealers are institutions that are actively buying and selling currency and OTC derivatives both for their own account and/or to meet customer demand. In practice, reporting dealers are often those institutions that actively or regularly deal through electronic platforms, such as EBS or Reuters dealing facilities. The category of reporting dealers also includes the branches and subsidiaries of institutions operating in multiple locations that have sales desks, but not necessarily trading desks, which conduct active business with large customers. "Other financial institutions" are defined as those financial institutions that are not classified as reporting dealers. Thus, they mainly cover all other financial institutions, such as smaller commercial banks, investment banks and securities houses, and in addition mutual funds, pension funds, hedge funds, currency funds, money market funds, building societies, leasing companies, insurance companies, financial subsidiaries of corporate firms and central banks. "Non-financial customers" are defined as any counterparty other than those described above, i.e. mainly non-financial end users, such as corporations and governments. See BIS (2010).

market (12% of the total). As Table 12.2 shows, the market is increasingly concentrated in the banking industry in most of the top 13 global FX centres (covering 90% of global turnover). Daily average turnover in the global **OTC interest rate market** is equally split between the two categories of financial institutions, accounting together almost 90% of total activity. The share of non-financial customers is the lowest (6%) in the FRAs market (which overall accounts for 29% of total turnover). It doubles in the market for swaps (overall 61% of turnover), while reaching 14% for options and other products. All in all, the data show that at least 11-13% of turnover is attributable to counterparties other than financial institutions.

Table 12.1

Global foreign exchange market turnover by instrument and counterparty[1]

Daily averages in April, in billions of US dollars and percentages

Instrument/counterparty	1998		2001		2004		2007		2010	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Spot	**568**	**37**	**386**	**31**	**631**	**33**	**1,005**	**30**	**1,490**	**37**
with reporting dealers	347	61	216	56	310	49	426	42	518	35
with other financial institutions	121	21	111	29	213	34	394	39	755	51
with non-financial customers	99	18	58	15	108	17	184	18	217	15
Outright forwards	**128**	**8**	**130**	**11**	**209**	**11**	**362**	**11**	**475**	**12**
with reporting dealers	49	38	52	40	73	35	96	27	113	24
with other financial institutions	34	27	41	31	80	38	159	44	254	54
with non-financial customers	44	35	37	29	56	27	107	30	108	23
Foreign exchange swaps	**734**	**48**	**656**	**53**	**954**	**49**	**1,714**	**52**	**1,765**	**44**
with reporting dealers	511	70	419	64	573	60	796	46	837	47
with other financial institutions	124	17	177	27	293	31	682	40	758	43
with non-financial customers	98	13	60	9	89	9	236	14	170	10
Currency swaps	**10**	**1**	**7**	**1**	**21**	**1**	**31**	**1**	**43**	**1**
with reporting dealers	5	55	4	53	12	58	12	39	20	47
with other financial institutions	2	23	2	21	5	23	13	41	19	45
with non-financial customers	2	22	2	25	3	14	6	20	4	8
FX options and other products[2]	**87**	**6**	**60**	**5**	**119**	**6**	**212**	**6**	**207**	**5**
with reporting dealers	48	55	28	47	49	41	62	29	60	29
with other financial institutions	18	20	15	26	44	37	91	43	113	55
with non-financial customers	21	24	16	27	21	18	59	28	33	16
Total	**1,527**	**100**	**1,239**	**100**	**1,934**	**100**	**3,324**	**100**	**3,981**	**100**
with reporting dealers	961	63	719	58	1,018	53	1,392	42	1,548	39
with other financial institutions	299	20	346	28	634	33	1,339	40	1,900	48
with non-financial customers	266	17	174	14	276	14	593	18	533	13
Local	698	46	525	42	743	38	1,274	38	1,395	35
Cross-border	828	54	713	58	1,185	61	2,051	62	2,586	65

[1] Adjusted for local and cross-border inter-dealer double-counting (ie "net-net" basis). Due to incomplete reporting, components do not always add up to totals. [2] The category "other FX products" covers highly leveraged transactions and/or trades whose notional amount is variable and where a decomposition into individual plain vanilla components was impractical or impossible.

Source: BIS: Triennial Central Bank Survey – Report on global foreign exchange market activity in 2010

Table 12.2

Concentration in the banking industry

Number of banks accounting for 75% of foreign exchange turnover (*)

Country	1998	2001	2004	2007	2010
EU countries					
Denmark	3	3	2	2	3
Sweden	3	3	3	3	3
France	7	6	6	4	4
Germany	9	5	4	5	5
United Kingdom	24	17	16	12	9
Non-EU countries					
Switzerland	7	6	5	3	2
Canada	6	5	4	6	5
Australia	9	10	8	8	7
United States	20	13	11	10	7
Japan	19	17	11	9	8
Singapore	23	18	11	11	10
Hong Kong SAR	26	14	11	12	14
Korea	21	14	12	12	16

(*) Spot transactions, outright forwards and FX swaps.

Source: BIS: Triennial Central Bank Survey – Report on global foreign exchange market activity in 2010

Table 12.3

Global OTC interest rate market turnover by instrument, counterparty[1]

Daily averages in April, in billions of US dollars and percentages

Instrument/counterparty	1998		2001		2004		2007		2010	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
FRAs	**74**	**28**	**129**	**26**	**233**	**23**	**258**	**15**	**601**	**29**
with reporting dealers	46	61	88	68	112	48	143	55	296	49
with other financial institutions	21	29	37	28	113	48	89	34	267	44
with non-financial customers	7	10	5	4	8	3	27	10	37	6
Swaps	**155**	**58**	**331**	**68**	**621**	**61**	**1,210**	**72**	**1,275**	**61**
with reporting dealers	87	56	219	66	325	52	552	46	537	42
with other financial institutions	56	36	98	30	241	39	574	47	585	46
with non-financial customers	11	7	14	4	55	9	85	7	154	12
Options and other products[2]	**36**	**14**	**29**	**6**	**171**	**17**	**217**	**13**	**208**	**10**
with reporting dealers	17	46	16	55	57	34	106	49	87	42
with other financial institutions	12	32	7	26	96	56	85	39	90	43
with non-financial customers	8	21	5	18	16	9	24	11	30	14
Total	**265**	**100**	**489**	**100**	**1,025**	**100**	**1,686**	**100**	**2,083**	**100**
with reporting dealers	150	56	323	66	494	48	800	47	920	44
with other financial institutions	89	34	142	29	450	44	747	44	942	45
with non-financial customers	27	10	25	5	79	8	136	8	221	11
Local	133	50	207	42	414	40	564	33	762	37
Cross-border	132	50	282	58	609	59	1,120	66	1,321	63

[1] Adjusted for local and cross-border inter-dealer double-counting (ie "net-net" basis). Due to incomplete reporting, components do not always add up to totals. [2] The category "other interest rate products" covers highly leveraged transactions and/or trades whose notional amount is variable and where a decomposition into individual plain vanilla components was impractical or impossible.

Source: BIS: Triennial Central Bank Survey – Report on global foreign exchange market activity in 2010

As long as taxes induce behavioural reactions and thus changes in relative prices, the ultimate burden will differ from the legal incidence. Given the implications in terms of distribution of welfare within the society, understanding economic tax incidence is crucial, particularly when taxes aim at generating contributions from certain income groups or industries, like is the case in the ongoing debate on a financial sector making a "fair and substantial" contribution to repay the cost of the crisis. The extent to which taxes on the financial sector are likely to be partly of fully rolled over to consumers depends on the price elasticity of demand and supply, and on the general competitive conditions in the relevant markets where the taxpayer

operates. Moreover, the pass through will be influenced by how widespread the adoption of the tax is. All in all, although the economic incidence of the tax instruments under analysis remains uncertain ex ante, part of the tax burden is likely to fall on final consumers of financial services. The extent of the pass through will most likely differ not only across the different types of taxes, but also across the possible variants of the same tax instrument.

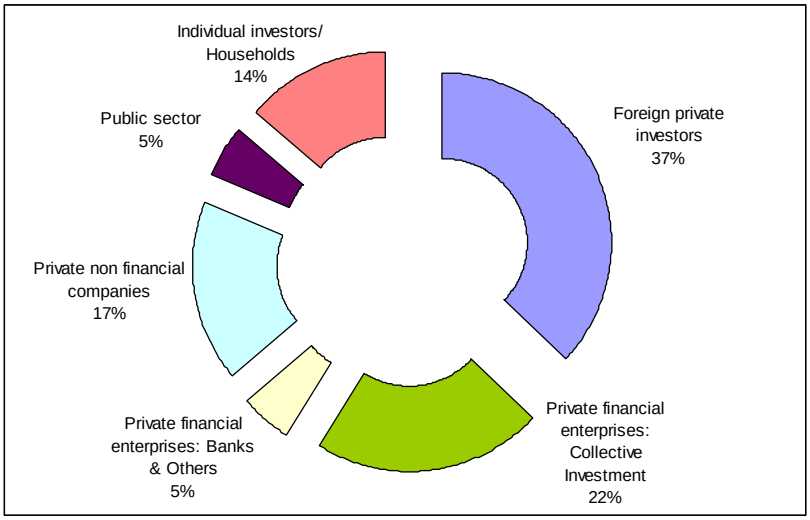
As far as the FTT is concerned, a large part of the burden would fall on direct and indirect owners of traded financial instruments. Moreover, in case the tax is levied on secondary markets, each transaction will be subject to it. This implies cascading effects which might have non-transparent consequences, and make incidence more complex. Also, if business transactions are non exempt, the tax will be cascading through the production process and affect the price of non-financial products. All in all, as recognised by Shackelford, Shaviro and Slemrod (2011) among others, the FTT is likely to turn out not effective *"at retrospectively targeting those who caused, or profited from, the recent financial crisis*".

As a rough indication, the ownership structure for traded shares in Europe is depicted in Figure 12.1[3]. Overall, 63% of market capitalisation is accounted for by domestic investors. Among them, the lion's share is played by collective investment institutions (22% of the total), comprising pension funds, insurance companies, mutual funds and collective financial investment companies. Taking into account the share owned by banks and other financial enterprises, such as bond issuing mortgage companies, the ownership share of domestic private financial enterprises amounts to 27% of total market capitalisation. Private non financial companies and organisations (including foundations and trusts) own 17% of the market value of listed shares in Europe, while the aggregate share owned by households and individual investors is in the range of 14%[4].

[3] The data are for 2007 and account for 90% of market capitalization in the countries covered. The breakdown by type of owners is only available for domestic investors. See FESE – Share ownership structure in Europe in 2007.

[4] There are significant differences across national markets, particularly between the UK and the other exchanges. The participation of private financial enterprises tops at 44.4% of the national market capitalisation in the UK, while it is in the 19-27% range for most countries in continental Europe. The lowest shares for financial companies are recorded in the smallest markets in Central and Eastern Europe. The participation of private non-financial companies is in the range of 40% in Germany and Bulgaria, while it is only 2.7% in the UK. Lower dispersion across national markets is shown by the ownership shares of households and individual investors, ranging from 2% in the Slovak Republic to 26.6% in Italy.

Figure 12.1 Share ownership structure of the European listed companies (end of 2007)



Source: FESE – Share Ownership Structure in Europe 2007.

The economic burden of the FAT might also be partly shifted to the users of financial services and products. Again, the precise design of the tax has non trivial consequences on the likelihood of the pass-through. As discussed in IMF (2010), the incentives to shift the FAT are lower in case the tax falls on pure rents. As a consequence, the extent to which the different variants of the FAT are passed on to final consumers may hinge upon the effectiveness of the rent-taxing and of the risk-taxing version of the FAT (Options 2B and 2C, respectively) at (identifying and) targeting excessive returns, particularly to the labour factor.

In the absence of robust empirical results on the incidence of the FAT, available evidence on the ability to shift the corporate income tax might provide useful indications on the economic incidence of potential new taxes imposed on the financial sector. The literature reviewed in Annex 9 shows that pre-tax profits in the banking sector are positively associated with the statutory CIT rate. This is considered an indication that the tax is shifted: in fact, banks are able to shift at least 90 percent of their corporate income tax burden to their customers. Interestingly, tax shifting takes place through the traditional lending activity instead of the provision of fee-generating services: while net interest income is positively associated with the CIT rate, non-interest income correlates negatively with the tax rate[5]. In addition, disentangling the overall effect on the interest margin shows that the impact concerns borrowers almost exclusively. All in all, the evidence suggests that, due to the presence of non-linearities in the effect of taxes, for low levels of the CIT rate higher taxes are likely to be translated into increased lending rates.

Of course, these findings are purely indicative of the potential pass-through of the taxes instruments under analysis, given their significantly different characteristics (e.g. the ability of the FAT to tax pure rents compared to the CIT), and the fact that, in contrast to them, the CIT

[5] Huizinga, Voget and Wagner (2011) also find that that international double taxation of dividends – but not of interests – is positively associated with the net interest margin of international banks. The point estimates imply a pass-through to bank customers and capital providers in the range of 90%.

has general application to all industries. In fact, some stylized evidence for the FAT as implemented in Denmark seem to suggest that the tax was not likely to have been passed to bank customers [6]. Nonetheless, in the light of the conclusions reached in the literature review that that "*increased taxation of the financial sector is likely to make lending more costly*" (see Annex 9), a rough quantitative grasp of the customers who might bear the economic burden of the tax can be obtained from Table 12.4, which shows the structure of bank lending in the EU 27. Loans to non-financial corporations (NFCs) account for about one fourth of the value of total outstanding loans. The percentages vary significantly across countries, ranging from less than 15% in Luxembourg and the United Kingdom, to more than 50% in Bulgaria. Loans to households are about 30% of total outstanding loans; about three quarters of the aggregate are destined to housing purchase, while the remaining is roughly equally split between other lending and consumer credit. Overall, the structure of household lending follows similar patterns within homogenous groups of countries: in the NMS in Central and Eastern Europe, excluding Lithuania, loans for consumer credit are well above other lending; in Bulgaria and Romania, they represent the most relevant lending category. The ability to pass-through the tax depends of course on the elasticities on the different market segments. For instance, in the case of NFCs lending, the accessibility of sources of finance alternative to bank credit is crucial, particularly for SMEs. Likewise, the elasticity of demand for household finance might be significantly affected not only by substitution possibilities but also by broader macroeconomic conditions and individual characteristics. This implies that a full assessment of the economic incidence of the taxes needs to take into account also the equity aspects of the distributional impacts. These are discussed in more detail in Annex 13.

[6] Presentation at the 2011 Brussels Tax Forum. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/conferences/taxforum2011/birch-sorensen_ppt.pdf

Table 12.4.

Loans from credit institutions

Stocks at December 2010, in millions of euros

	Total	of which:			
		to NFCs	to households		
			for consumer credit	for housing purchase	other lending
AT	580,939	159,095	24,705	80,000	36,351
BE	546,749	111,651	8,762	84,576	16,864
BG	30,995	16,211	4,725	4,453	530
CY	75,090	24,004	3,394	12,035	7,389
CZ	104,602	31,221	8,047	29,412	4,717
DE	4,611,763	893,818	185,551	968,542	269,861
DK	632,398	144,179	15,720	272,178	26,191
EE	15,944	6,519	662	5,971	579
ES	2,275,281	914,876	82,183	665,221	132,072
FI	215,422	58,487	12,563	76,747	14,978
FR	4,021,005	838,816	154,761	775,265	80,778
GR	337,482	117,563	35,058	79,538	18,576
HU	81,157	27,324	14,030	15,662	1,273
IE	604,393	105,045	19,968	99,688	13,366
IT	2,428,928	880,373	62,494	352,267	178,312
LT	19,142	8,426	931	5,983	1,002
LU	430,706	56,189	1,683	18,591	11,410
LV	20,348	8,806	919	6,498	675
MT	15,247	5,278	366	2,684	697
NL	1,209,502	348,829	28,883	361,431	22,821
PL	217,613	53,985	32,779	67,425	21,352
PT	336,955	120,799	15,524	114,560	12,240
RO	66,983	24,553	15,082	6,794	2,091
SE	612,904	190,159	17,658	223,745	39,159
SI	38,978	21,025	2,834	4,844	1,612
SK	37,157	15,138	3,120	10,849	1,620
UK	4,055,686	561,640	149,391	1,170,543	52,266
EU27	23,623,369	5,744,009	901,793	5,515,502	968,782

Source: ECB, MFIs statistics

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COMMISSION STAFF WORKING PAPER

IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

{COM(2011) 594 final}
{SEC(2011) 1103 final}

ANNEX 13

EQUITY ASPECTS

The equity aspects are analysed with respect to two main issues. First, the capacity of the tax instruments under analysis to target intermediaries that are more risky is assessed. Second, the potential distributional effects arising from the taxes being shifted to consumers are discussed.

1. Taxes and risk

The likelihood of the taxes to target particularly risky financial institutions can be assessed in a static way by looking at the correlation between the tax charge and measures for riskiness. This exercise is particularly meaningful once one takes into account the policy objective of having the financial sector make a "fair and substantial contribution" to recovering the costs of the past crisis. While there is no data on the institution-specific contributions to revenues from the FTT, the bank-level data in the ORBIS database can be used to calculate not only the yield from the FAT (see Section 6.2.2 in the main document), but also the relationship between the tax charge and other individual characteristics. Interestingly, for all the three variants of the FAT the simple correlation between revenues and leverage – as a measure for risk – is practically nil. In contrast, the correlation with assets is as high as 0.75 for the addition-method FAT (FAT1), while it decreases to 0.46 for the risk-taxing FAT (FAT3).

A more sophisticated forward-looking approach consists in evaluating the correlation of the FAT revenues with the individual contribution of banks to the expected losses that would not be covered by the existing (and envisaged) tools for crisis resolution. This analysis is presented in detail in Annex 14.

2. Distributional impacts on consumers

To the extent that taxes on the financial sector are passed on through higher prices (see Annex 12) it is of paramount importance to disentangle which types of final users are most likely to suffer. Taxes on the financial sector could have a progressive effect if they fall disproportionately on high-income individuals, but middle and lower-income earners would also be affected. Moreover, it might be easier for wealthy investors, borrowers or lenders to avoid taxation by relocating to other markets. Importantly, as the use of the broad range of

financial instruments may markedly differ across income levels, the alternative tax instruments discussed entail dissimilar impacts on the different social strata. Thus, this analysis looks at the use of financial services by households across the income distribution using available evidence from different sources. First, it presents evidence on household expenditure on insurance and financial products in the EU. The analysis shows that mean spending on insurance is increasing by moving up the income quintiles for the majority of the EU MS. This conclusion is supported by aggregate average data on both the EU-27 and the Euro area, where the highest marginal increase can be observed at the fourth quintile. Important data limitations do not allow one to draw a similar conclusion in the case of consumption expenditures on financial services. Second, we report evidence on household ownership of financial assets and liabilities in selected Euro area countries, taken from national surveys on household finances. The data point to significant differences in the frequency of ownership of financial assets across the income distribution. Moreover, while bank deposits and sight accounts are in general equally widespread among the different income quantiles, the ownership of more sophisticated and risky financial instruments appears concentrated within the high-income households. On the liabilities side, mortgages represent the most relevant debt item for households, both in terms of volume and frequency. While they show the lowest participation in the mortgages market, households in the bottom income quartile seem the most vulnerable to changes in the cost of the loans, given the high levels of the service-to-income ratio.

2.1. Structure of private households expenditure on insurance and financial services

This section uses data on consumption expenditure by income quintile and detailed COICOP from the Household Budget Surveys (HBSs) for 2005 from Eurostat to investigate the existence of particular patterns behind consumption expenditure of private households on insurance and financial services by income quintiles[1].

[1] HBS are national surveys on consumption expenditure carried out in all EU Member States. The frequency of dissemination of the households' data is approximately every five year and the last available reference year is 2005. The period from the reference year to the publication of data ranges between 1 and 4 years depending on the country; the 2005 data was published in April 2008. The HBS data were weighted to correct for bias in the sample that might lead to divergence between the sample and the reference population. The design weights are calculated for each sampled household as the inverse of its probability of selection into the sample. The HBS expenditure data, as every sample survey data, are liable to sampling errors, which depend inter alia on the sample size. The data quality also reflects non-responses or under-reporting of some types of consumption expenditures. In order to reduce the bias from non-reporting the sample weights were inflated by applying correction factors. Eurostat declares

Mean Consumption expenditure on insurance

Figure 17.1 presents the data on consumption expenditure on insurance products by income quintile for all EU Member States except for Italy, where observations are not available. Insurance services include: **(1) dwelling** - charges paid by owner-occupiers and by tenants for the kinds of insurance typically taken out by tenants against fire, theft, water damage, etc; **(2) health** - charges for sickness and accident insurance; **(3) transport** - charges for insurance in respect of personal transport equipment; charges for travel insurance and luggage insurance and **(4) others** - charges for other insurance such as civil liability for injury or damage to third parties or their property. Hence, life insurance products are not covered.

The data series is constructed as structural indicator and depicts the distribution of the total mean (average) expenditure of private households on insurance. The indicator, made available by Eurostat, is calculated per thousands. Each income quintile contains 20% of the country's population ordered by income, with 1 being the poorest and 5 being the wealthiest. Figure 17.1 shows that household spending on insurance is the highest in the Netherlands, with an average of EUR 125 per thousand[2]. One could equally say that 12.5 percent of mean consumption expenditure goes into insurance products in the Netherlands. The second highest ratio can be observed in Germany (EUR 64 per thousand), the third highest in France (63) and the fourth highest in Slovenia with an average of EUR 55 per thousand. The lowest insurance to total expenditure ratio of EUR 1.4 per thousand can be observed in Romania, just below Bulgaria (EUR 1.8), Lithuania (EUR 6.4) and Poland (EUR 8.6 per thousand). This breakdown is not surprising since in general the richer (in GDP terms) the country the higher the value of the goods and services to be insured. The magnitude of the difference, however,

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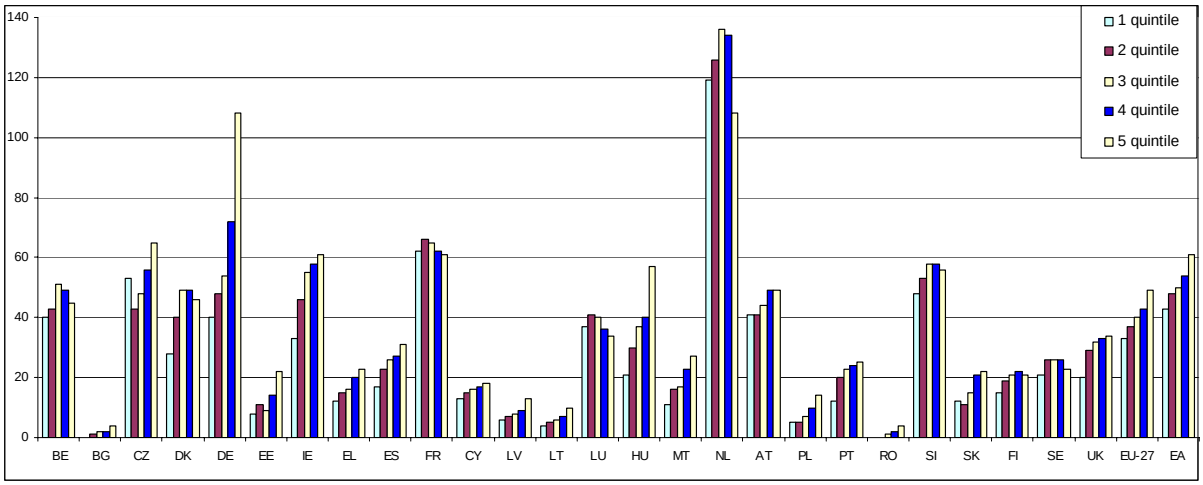
under-reporting as probably the most serious problem affecting HBS's data quality. Some spending on consumption is not reported because of the nature of the goods consumed such as drugs, alcohol and tobacco etc. The consequence is an underestimation of the weights for these items and an overestimation of the weights for the correctly reported items. All the HBSs for the reference year 2005 are sample surveys of private households. The vast majority of the participating countries chose a sample of households on the base of probability design, which implies that the probability of a household being selected is known. Germany and Czech Republic applied quota selection (non-probability scheme), which means that there is no guaranty that the sample selection is representative and not biased. The advantage of the probability design method lies in the possibility to project the outcome on the base of the selected sample to the household population with known levels of accuracy, i.e. standard errors and confidence intervals can be calculated. For a complete methodology, see Eurostat (2003): Household Budget Surveys in the EU: Methodology and recommendations for harmonisation, available at: http://epp.eurostat.ec.europa.eu/cache/ITY_SDDS/Annexes/hbs_esms_an2.pdf

[2] It is to be mentioned that the value of this structural indicator does not change if one uses Euros or PPS since the indicator is build as a ratio i.e. the denominator and nominator will be both multiplied by the same coefficient.

is considerable: the four countries with the highest insurance/consumption ratio spend on average[3] 17 times more on insurance than the four low ratio countries. This is also reflected in the distribution of consumption expenditure on insurance in the EU-27 and the wealthier Euro area. The mean spending on insurance in the EU-27 and the Euro area is respectively 40 and 51, with an average percentage difference of 24.

Figure 1: Mean consumption expenditure on insurance by income quintile in 2005 per thousands.



Source: EUROSTAT (2011): Household Budget Surveys[4].

Moving to the analysis of distributional issues within countries, one observes that in the majority of the countries consumption expenditures on insurance are increasing by moving up the income quintiles. This observation is valid for every single quintile i.e. the spending on insurance is either equal or above that of the preceding quintile. Moreover, the marginal increase by moving up the income quintiles is, in the majority of the countries, sizable in magnitude. For instance, in Romania and Bulgaria the insurance expenditures of the fifth quintile are 4 times higher than these of the first/second quintile; in Poland the same measure is 2.8 times higher and in Lithuania 2.5 times higher. From the Euro area countries the most significant difference can be observed in Germany: the fifth quintile spends 2.7 times more on insurance than the first quintile and the marginal average spending between the fourth and the fifth quintile is 40 percent. There are cases, however, where this conclusion can not be drawn,

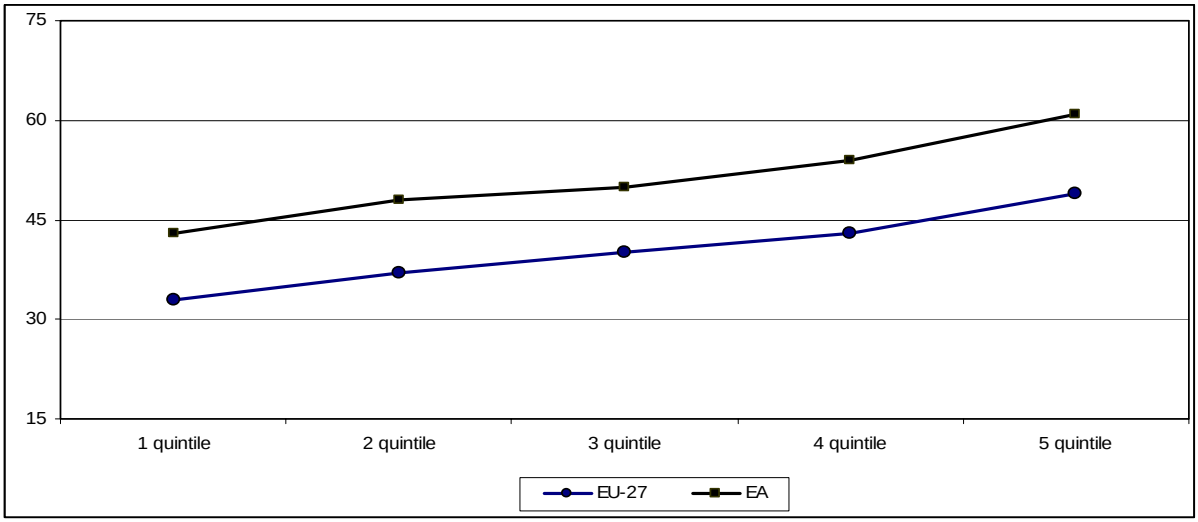
[3] Averages are calculated arithmetically.

[4] Household Budget Surveys: database available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/household_budget_surveys/Data/database

as for example in France or Netherlands. In the former, the second quintile exhibits the highest spending on insurance (EUR 66 /thousands), whereas it is the third quintile (EUR 136 /thousands) in the Netherlands.

Apart from this, the distribution of the average aggregate consumption spending in the EU-27 as well as in the Euro area provides evidence that consumption expenditures on insurance is increasing by moving up the income quintiles. From Figure 2 one can easily observe that marginal spending on insurance in relation to the increasing number of the income quintile is positive for both the EU-27 and the Euro area. In addition to that, the pattern of marginal spending according to the income quintile seems to be similar in both areas, with the marginal increase recorded at the fourth quintile.

Figure 2: Mean consumption expenditures on insurance by income quintile in 2005



Source: EUROSTAT (2011): Household Budget Surveys.

Mean Consumption expenditure on financial services

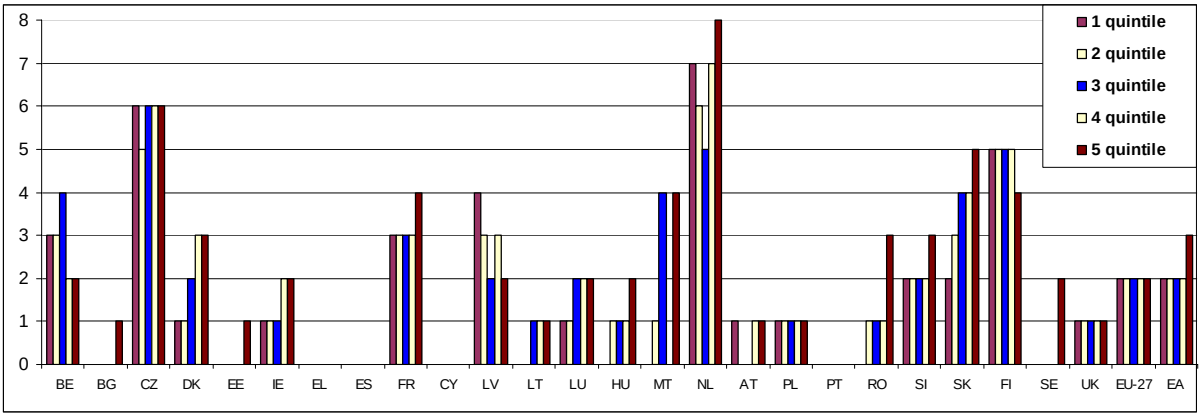
Figure 13.3 depicts consumption expenditure of private households on financial services by income quintile for all EU Member States, except Italy and Germany, where data is not available. Financial services include: **(1)** actual charges for the financial services of banks, post offices, saving banks, money changers and similar financial institutions; **(2)** fees and service charges of brokers, investment counsellors, tax consultants and the like and **(3)**

administrative charges of private pension funds and the like. Hence, the data do not cover the actual amount of savings or investment but only the fees linked to these operations.

In contrast to the statistics on insurance, the data series on financial services suffers from two significant drawbacks. In the first place, as shown in Figure 17.3, four countries - Greece, Spain, Cyprus and Portugal - seems to have reported zero expenditure on financial services which is, as a matter of fact, dubious. Another important drawback of the data is the small variation, which seems to be partly due to rounding. By simply looking at Figure 17.3, one observes in many cases the same values for different income quintiles. It is, therefore, not possible to judge on the way consumption expenditure are changing by moving up the income quintiles.

Nonetheless, the highest consumption expenditure on financial services can be observed in the Netherlands with an average of EUR 6.6 per thousand. It is interesting that the Netherlands are the biggest spenders on insurance and financial services in the EU-27. The second, the third and the fourth highest mean spending on financial services can be observed in the Czech Republic (5.8), in Finland (4.8) and in Slovakia (3.6) respectively. The lowest ratio, apart from the above mentioned zero values countries, can be monitored in Bulgaria with an average spending on financial services of EUR 0.2 per thousand.

Figure 3: Mean consumption expenditure on financial services by income quintile in 2005 per thousands.



Source: EUROSTAT (2011): Household Budget Surveys.

2.2. Households' financial assets and liabilities

Additional evidence on the ownership distribution of financial products can be obtained from national household surveys. These surveys are administered independently by the MS, so the questionnaires and periodicity are not harmonised. Hence, the detail of information available

might substantially differ across countries. The evidence reported here refers to selected MS, and shows that overall the frequency of ownership of financial assets varies with household income and with the educational attainment and work status of the head of the household. As such, it is fully consistent with the findings from the harmonised HBS described in the previous section.

According to the French Household Income and Wealth survey[5], savings certificates with a favourable fiscal treatment are the most common financial asset held by private households in France in 2004. Overall, 82.6% of surveyed households reports ownership of such instrument. The percentage of ownership decreases significantly (to 50.7%) only for households declaring total wealth below EUR 3,000 (6.8% of households), whereas it remains in the 80-90% range for wealthier households. Securities are held by 24.2% of French households, with marked differences according to the wealth level. Among the households with net wealth between EUR 3,000 and 105,000 (roughly 40.5 % of the total of households), 11.9% own securities. The percentage rises to 30.3 % for the households with wealth between EUR 105,000 and 450,000 (44.3% of total households), and to 70.1% for households with wealth above EUR 450,000 (8.4% of households). A similar pattern can be observed for life insurance products and supplementary pension products: the percentages of ownership range from approximately 8% for households with wealth below EUR 3,000 to 75% for the top-wealth ones.

The Italian Household Income and Wealth survey[6] shows that in 2008 almost 90% of Italian households own at least one financial asset. Among lower-income households, up to the second quintile, post office savings certificates are the most widely held type of asset after deposits. Government securities, corporate bonds and investment funds figure prominently in the holdings of upper-income households (fourth and fifth quintiles). In particular, among the households in the first income quartile only 0.3% own shares, while 0.6% own bonds and mutual funds. For the households in the top income decile the percentages top to 17.8 and 30.6%, respectively. The distribution of ownership follows a similar pattern when the educational qualification of the head of the household is considered. As far as insurance products are concerned, life insurance is held by 2.9% of households below the first income quartile, while for those in the top decile this percentage increases tenfold (29.4%). The share

[5] INSEE, Les revenues et le patrimoine des ménages, édition 2010 – Fiches Thématiques Patrimoine. Available at: http://www.insee.fr/fr/ffc/docs_ffc/ref/revpmen10h.PDF

[6] Bank of Italy, Supplements to the Statistical Bulletin - Household Income and Wealth in 2008. Available at: http://www.bancaditalia.it/statistiche/indcamp/bilfait/boll_stat/en_suppl_08_10.pdf .

of ownership of supplementary pensions is limited to 1.3% of the households in the first income quartile, whereas it reaches 19.2% among those in the top decile.

According to the Spanish Household Finances Survey[7], bank deposits represent 49% of the total value of financial assets of households in 2008. Pension plans account for 18.2% of the assets, followed by publicly listed shares (9.3%), OTC shares (8%), investment funds (7.1%) and fixed income securities (1.7%). The composition of households' portfolios tends to be rather similar across the different classes of income, with the exception of the top income decile for which OTC stocks are the third most relevant category (17% of households owns that type of asset). Overall, the fraction of households reporting direct ownership of publicly listed shares and investment funds is 10.4%. However, among the lower-income households, up to the first quintile, only 3.5% directly own such shares, whereas for the top decile this percentage is 34.9%. Likewise, household in the top income decile are the most likely to invest in funds: 18.4% reports this type of investment, against 2.1% of households in the lowest income quintile (with the overall share of households around 5.6 %). Household liabilities represent 10.3% of the total value of the assets. The lion's share (59.6%) of household debt is mortgage finance for the purchase of the main residence, whereas mortgages for the purchase of other real estate account for 24.6% of total liabilities. In the first quarter of 2009, 50.1% of households have some type of loans, and 26.3% of households have loans to finance the purchase of dwellings. Households in the middle deciles of the income distribution are the most likely to have mortgages with this purpose. The median value of the loan is around EUR 53,900 for all households; the median volume increases with income and decreases with wealth. Overall, 7.9% of households have outstanding loans aimed at buying other real estate. In this case, the ownership share increases monotonically with the level of income, ranging from 0.7% for households in the bottom quintile to 23.3% for those in the top decile. The median value of such loans is EUR 63,000, without a clearly identifiable pattern across the income and wealth distributions. Among the other types of loans, the most widespread are those for personal credit (owned by 23.1% of households). While almost one out of three households between the fourth and the ninth income decile reports ownership of this type of loan, the participation rate of households in the first quintile is limited to 9%.

[7] Banco de España, Encuesta Financiera de las Familias (EEF) 2008: Métodos, Resultados y Cambios desde 2005. Available at: http://www.bde.es/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/10/Dic/Fich/art2.pdf

2.3. Housing finance

Debt for house purchase represents households' largest liability category. It makes up a significant part of bank lending. Hence, information on the distribution of loans to households for house purchase across household classes is useful for determining vulnerabilities associated with changes in interest rates, for instance as a consequence of potential shifting of taxes on financial institutions. Some evidence on the distribution of mortgages by income and age classes for selected Euro area (EA) members is provided in ECB (2009)[8], with respect to several indicators. Among them, the share of households with mortgages and the debt service ratio (for households with this kind of debt) are reviewed here. Data availability is limited to Germany, Ireland, Greece, Spain, France, Italy, the Netherlands and Portugal, and is up to 2007[9].

Household participation in the mortgage market is very heterogeneous across the countries under analysis, with the percentage of households with mortgages ranging from 12% in Italy to almost 40% in the Netherlands (see Figure 13.4). The share of households with mortgages increases monotonically with the income. In particular, households in the lowest income quartile have a significantly lower participation rate than those in the top two income quartiles. Concerning age classes, in Spain and Portugal, participation in the mortgage market essentially decreases the lower is the age of the household head. In the other countries, participation first increases up to the second or third age class, and then decreases with age. In the youngest age class (< 35 years), the dispersion of the participation rate is the largest, with the share of such households with mortgages ranging from 12% in Greece and 53% in Portugal. Among the households with a head aged between 35 and 44 years, who are the most likely to have mortgages, the differences across countries are smaller.

The debt service ratio measures the share of their disposable income that households pay to service the mortgage, i.e. for interest and principal repayment. This indicator is useful to evaluate the vulnerability of households to changes in the cost of debt for countries with a

[8] ECB: Housing Finance in the Euro area, Occasional Paper 101, March 2009. Available at: http://www.ecb.int/pub/pdf/scpops/ecbocp101.pdf

[9] When data from several years are available, the evidence reported refers to the latest survey. The time coverage varies across countries as follows: Germany: 2003; Ireland: 2005; Greece: 2007; Spain: 2005; France: 2004; Italy: 2006; the Netherlands: 2007; Portugal: 2006.

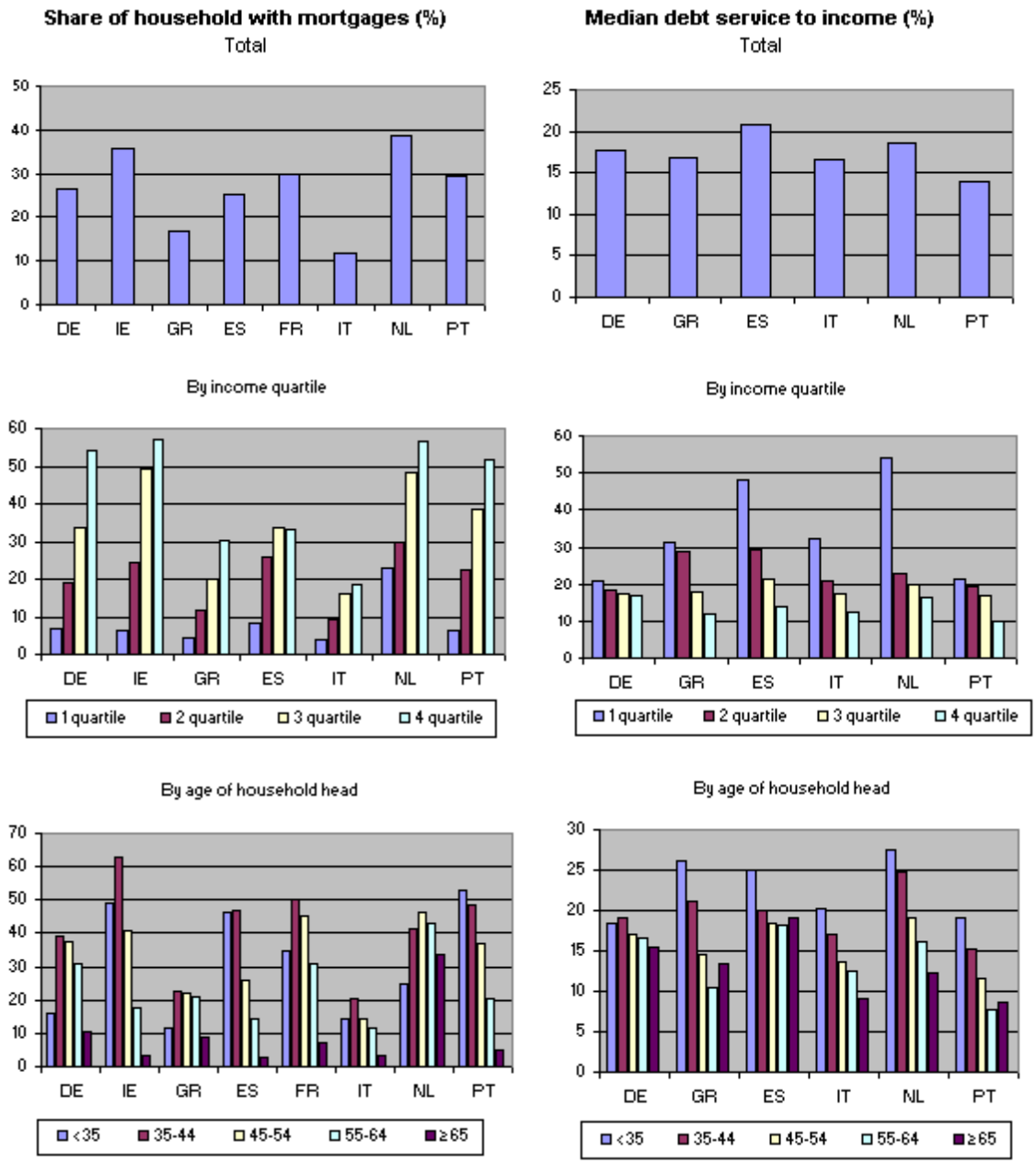
large share of variable rate mortgages[10]. Overall, despite differences in mortgage market participation rates, the debt service for such households is rather similar across countries, ranging from 14% in Portugal to 21% in Spain. The similarity can possibly be explained by long repayment terms, keeping the median ratio of debt service-to-income more affordable; for instance, Italy had a shorter typical mortgage maturity than the other countries, and this is reflected in a higher value of this ratio. The debt service ratio decreases with the household income, although this trend is less clear in Germany and Portugal. Overall, in Greece, Spain, Italy and the Netherlands households in the lowest income class already devoted more than one-third of their disposable income to service their mortgages in the period from 2005 to 2007; they therefore look particularly vulnerable to increases in interest rates, especially when mortgages are taken out at variable rates. As for the distribution across age classes, evidence is similar for the different countries, and points to a decreasing debt service with age.

In summary, participation in the mortgage market is the highest for high-income households, whereas the fraction of households with mortgage debt in the lowest income quartiles is generally limited. In some countries, participation is also particularly high for the households in the youngest age class, who are more likely, even if they have high incomes, to hold a lower amount of total assets. Overall, there are some groups of households, belonging mainly to the lowest income quartiles and to the youngest age class, who have reached high levels of the debt service ratio. These households are therefore particularly vulnerable to changes in interest rates.

[10] An important drawback of the debt service-to-income ratio is that it reflects debt sustainability only in the short term. The indicator is therefore often complemented with other ratios such as the ratios of the mortgage to disposable income and to total assets. This latter, in particular, is a useful indicator of

households' ability to pay back their loans, assuming that houses and stocks can be sold at prevailing prices if a household faces serious difficulties in repaying its debt.

Figure 4: Share of households with mortgages and median values of the debt-to-income ratios for selected EA countries (*)



(*) : median values are calculated only for households with mortgages.

Source: ECB (2009).

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IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

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ANNEX 14
EFFECTS ON MARKET STABILITY AND RISK

ESTIMATING BANKS' INDIVIDUAL CONTRIBUTIONS TO SYSTEMIC RISK: A SYMBOL-BASED APPROACH.

1. INTRODUCTION

The Commission is evaluating options regarding the introduction of a harmonized Financial Sector Taxation framework. Options under study include a Financial Activities Tax (FAT) and a Financial Transactions Tax (FTT). Details of these various options are studied so as to be in line with other regulatory proposals in the pipeline, aimed at strengthening the stability of the banking sector. In particular, the Commission has put forward new rules for banks' capital requirements, transposing into EU legislation the recent Basel 3 Accord, and is going to present a novel framework for crisis management. The latter, among other things, will introduce Resolution Funds (RF) whose function is that of limiting contagion effects across banks and thus of ensuring that bank failures can not take place in an uncontrolled fashion that would destabilise the financial system.

The aim of this work is to provide quantitative analysis supporting the Impact Assessment exercise on Financial Sector Taxation. In particular, the present contribution consists of an analysis, based on the model SYMBOL[1], estimating the probability and magnitude of systemic losses deriving from banks' defaults, explicitly taking into account the effects of Basel capital requirements, Deposit Guarantee Schemes (DGS) and bank Resolution Funds (RF).[2]

SYMBOL also provides results for the contribution of individual banks to the risk of the banking sector as a whole, both in the case where contagion effects are controlled fully by DGS/RF (and the associated crisis management tools) and in the case when these tools are not completely effective in managing the effects of banking defaults.

The analysis has been developed for 19 EU MS[3] using 2009 data for a sample of banks coming from *Bankscope* and augmented by further analysis by DG TAXUD, DG MARKT

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1 The SYMBOL model (**SY**stemic **M**odel of **B**anking **O**riginated **L**osses) has been jointly developed by the Joint Research Centre Financial Crisis Task Force, DG MARKT, and experts on banking regulation (see De Lisa et al., 2010).

2 In previous works, SYMBOL has been used to assess the impact of Basel III higher capital standards on the systemic losses and liquidity shortfalls deriving from banks' defaults. (see Marchesi *et* al., 2010).

3 These countries are Belgium, Bulgaria, Cyprus, Denmark, Finland, Germany, Greece, Ireland, Spain, France, Italy, Latvia, Luxembourg, Malta, Netherlands, Austria, Portugal, Sweden, and the United Kingdom.

and JRC, as well as integrations from Supervisory Authorities and/or Central Banks for some countries.[4] Moreover, some ECB data have been used to complete or correct the dataset.[5]

The remaining of this document develops as it follows. Section 2 introduces the SYMBOL model. Section 3 lists the main proposals on financial regulation incorporated in the SYMBOL analysis. Section 4 shows how SYMBOL has been used to obtain estimates of the banks' individual contributions to systemic expected losses. Section 5 contains some summary statistics of the results, examples for selected countries and information on how to read detailed results file.

Two Annexes are attached to this document. Annex A presents a summary table describing the samples used for SYMBOL simulation. Annex B gives mathematical details on the formulas applied to estimate banks individual expected yearly losses.

2. THE SYMBOL MODEL

SYMBOL starts by estimating individual bank credit losses which are generated via a Monte Carlo simulation according to the Basel FIRB function loss distribution. The average probability of default of the credit portfolio of each bank is estimated consistently with capital requirements, while other variables (LGD, correlation, etc.) are set at their default values.

Banks simulated losses are then compared with banks capital: whenever losses exceed capital, banks are considered to default.

The model proceeds by simulating contagion via the interbank market[6], in order to capture systemic linkages between banks besides the fact that their assets are correlated. In the absence of an effective intervention by resolution facilities[7], whenever a bank defaults it is assumed that 40% of the amounts of its interbank debits are passed as losses to creditor banks and distributed among them. Losses are distributed following a criterion of proportionality: the portion of loss absorbed by each 'infected' bank is proportional to its creditor exposure in the interbank market. Whenever with this additional loss the simulation shows that another bank's losses exceed its capital, that banks is also considered to default, and so on bank after bank until no new bank defaults.[8] Systemic losses are computed as the sum of the losses in

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4 Data from the Supervisory Authority and/or the Central Bank have been received from Bulgaria, Cyprus, Latvia, Ireland and United Kingdom.

5 Annex A contains aggregated data on relevant variables for the samples used.

6 Only domestic contagion is included in the version of SYMBOL used for the present report.

7 In the "best case" scenario, an RF operating in coordination with a liquidity facility is assumed to be able to neutralize contagion by absorbing a share of excess losses proportional to the size of a banks' interbank liabilities, while resolution and liquidity facilities are able to completely eliminate additional losses due to liquidation costs, fire sale effects and market congestion.

8 It is worth noting that contagion effects are sensitive to the two assumptions made: the 40% percentage of interbank debits that are passed as losses to creditor banks in case of failure, and the criterion of proportionality used to distribute these losses across banks, which is dependent on the fact that a bank-to-bank interbank lending matrix is not yet available to the Commission (although preliminary sensitivity analysis on this aspect points to the fact that the shape of the matrix should be less important than total size of interbank market). A loss of 40% on the interbank exposure is coherent with the upper

excess of capital over the entire bank sample. Distributions for the population of all banks in each MS are then obtained by rescaling the distributions proportionally according to the ratio of total assets in the sample and in the total banking sector in the MS.

3. FINANCIAL REGULATORY PROPOSALS INCORPORATED IN THE SYMBOL ANALYSIS

The Commission is currently presenting three distinct proposals on financial regulation:

1) A Capital Requirements Directive proposal (CRD IV), aimed at adopting the new rules proposed in the Basel 3 accord, including new definitions of capital for regulatory purposes, a new set of capital requirements for tier1 and total capital as a proportion of Risk Weighted Assets (RWA) and the introduction of a capital conservation buffer of 2.5% of RWA;
2) A Directive proposal aimed at strengthening Deposit Guarantee Schemes substantially enlarging their coverage (100,000 EUR) and, as a consequence, their funding;
3) A Directive proposal for an EU crisis management and banks resolution framework, including the creation of Resolution Funds in all MS.

The main features of these three proposals have been incorporated in the SYMBOL analysis, in order to come up with figures based on the most possible comprehensive view of all changes which are expected to impact the banking sector in the near future.

To take into account the effects of the new Basel 3 rules on capital requirements, distributions of losses are generated under the hypothesis that banks hold a capital equal at least to 8% or 10.5% of their risk weighted assets (i.e. excluding or including the presence of a mandatory capital conservation buffer).[9]

As far as Deposit Guarantee Schemes and Resolution Funds are concerned, instead, we base our working hypotheses on most recent version of these two proposals. In particular, the considered amount of funds available to DGS+RF purposes is the maximum between 1.5% of a country covered deposits and 0.3% of the amount of liabilities. Amounts of funds to be collected by the considered MS are reported in last column of Table A.1.[10]

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bound of economic research on this issue. See James (1991), Mistrulli (2007), Upper and Worms (2004).

9 Regarding Basel III, SYMBOL takes account at the moment of the consequences due to changes in the definition of capital and of Risk Weighted Assets in the trading book, securitization and counterparty risk, as well as the introduction of the capital conservation buffer. The leverage ratio and the new measures on liquidity can be possibly factored into the methodology used on the basis of how they modify contagion between banks via the interbank market.The analysis does for the moment also not include the effect of the stricter Tier1 constraints imposed by Basel III.

10 Figures in the last column of table A.1 refers to the sample of banks considered. As rules on the determination of the total amounts of funds available to DGS and RF in each MS are still under negotiation in the Council and the European Parliament, any rule adopted in the present study for simulation purposes can not reflect the final form of the rule as it will eventually be implemented. It was therefore chosen to calibrate funds available to DGS/RF on the basis of SYMBOL. In particular, preliminary SYMBOL results allows concluding that a calibration as the one considered would be effective and efficient, as it would ensure public finances to be hit in less than 0.05% of the cases.

4. METHODOLOGY

Estimates of the distribution of systemic losses deriving from banks defaults obtained using SYMBOL are presented under several "regulatory settings" and "contagion situations". Combinations of "settings" and "situations" identify the following "scenarios", representing joint assumptions on the regulatory set-up and the development of a financial crisis.

SYMBOL currently allows for two pairs of regulatory settings and two contagion situations:

1) Regulatory Settings

   The first regulatory setting regards the level of regulatory capital expressed as the minimum ratio of Capital to Risk Weighted Assets.

   The second regulatory setting regards the possibility of a "no bail-in" or a "bail-in" framework when DGS/RF absorbs losses. In the first case DGS/RF funds cover all non-equity creditors by absorbing losses of defaulted banks until funds are available; in the second case DGS/RF cover only insured depositors and inter-bank depositors (to avoid contagion), i.e. part of the losses would be absorbed by bondholders and depositors not eligible for insurance coverage.

2) Contagion Situations represent possible polar extremes of the effectiveness of interventions during the crisis:

   In the "best" situation, funds and facilities are assumed to be able to work in such a way that no additional losses due to liquidity or "fire sale" effects are generated, so that only economic losses due to defaults in bank's portfolios need to be covered, i.e. contagion effects are not considered.

   In the "worst" situation funds and facilities intervene, but they are not able to avoid liquidity and "fire sale" additional losses and to completely stop contagion.

In the current analysis the settings and situations explored are as follows:

A) Regulatory Capital Requirement Settings:

   Two different capital requirement settings are considered in order to evaluate the effects of the introduction or not of a mandatory "capital conservation buffer" for banks in Basel 3. In other words we distinguish between the situation where banks must hold a minimum capital equal to 8% of their Risk Weighted Assets (RWA) and the situation where a minimum capital conservation buffer of 2.5% is also put on top, so to reach at least a capital equal to 10.5% of RWA.

B) Bail-in / No bail-in Settings:

A single setting is considered in the current analysis, where private funds or state interventions are considered to cover all losses generated in the system.

C) Contagion Situations:

Two situations are considered: one where intervention is perfectly effective in blocking contagion, and one where interventions are only able to reimburse losses but are not able to prevent contagion.

The combination of these hypothesis yields four possible "scenarios", represented in Table 1.

Table 1: Scenario definition

Scenario	Capital Setting		*Bail-In* Setting		Situations	
	No Conservation Buffer, i.e. capital ≥ 8% RWA	**Conservation Buffer, i.e. capital ≥ 10.5% RWA**	**No Bail-In**	**Bail-In**	**Contagion**	**No Contagion**
1	X		X		X	
2	X		X			X
3		X	X		X	
4		X	X			X

Scenario 1 represents the worst (most risky) scenario: banks hold at least a capital of 8% of RWA, DGS/RF are ineffective in blocking contagion, and they cover all losses (no bail-in).

Scenario 2: while the minimum capital stays at 8% of RWA, DGS/RF are effective in blocking contagion (no contagion) and their interventions cover all losses (no bail-in)

Scenario 3: banks hold at least a capital of equal to 10.5% of RWA, DGS/RF are ineffective in blocking contagion, and they intervene to cover all losses (no bail-in).

Scenario 4 is the best (least risky) scenario where banks hold a minimum capital of 10.5% of their RWA, DGS/RF are effective in blocking contagion (no contagion), and they intervene to cover all losses (no bail-in).

For each of the scenarios, SYMBOL simulates excess losses for each individual bank in the sample. The sum of all of these losses is then used to generate the distribution of losses in each scenario.

SYMBOL is further used to estimate the contribution of each bank to systemic losses. The individual bank's contribution is defined as the expected average yearly loss of this bank (over the whole set of SYMBOL simulations).[11] A percentage contribution of each bank to the systemic risk is then obtained as the ratio of its individual contribution on the sum of individual contributions of all banks in each country.

The contribution of each bank to systemic loss is further divided in two parts: the contribution generated by each bank in all cases where the total loss is lower than RF/DGS available funds, and the contribution generated by each bank when the total losses exceed this amount.

5. SYMBOL RESULTS

The following results are based on a total number of SYMBOL simulations so to obtain for each country 100,000 runs where at least one bank defaults. This high number of run is needed in order to guarantee that in the right tail of the distribution a sufficient number of points is sampled. The results for the different versions of a FAT are presented in section 5.3. The discussion of the FTT - which cannot be explicitly modelled in SYMBOL – can be found in section 5.4.

[11] Our methodology is such that expected yearly losses are directly proportional to total losses. See Annex B below for mathematical details of the methodology used, which is a variation of the one proposed by Praschnik and Principato (2001). Contributions are calculated by excluding the more extreme events above the 99.999th quantile, in order to exclude the influence of events in the leftmost tail which could be suffering excess variance due to undersampling.

5.1. Distribution of excess losses

Tables 3-6 show some selected percentiles of the distribution of systemic losses under the various scenarios for all considered MS. Distributions presented in these tables refer to the bank populations and are therefore comparable across MS.

The tables report the cumulative distribution function of systemic excess losses. For instance for Scenario 1 in Belgium we can read that systemic excess losses are below 69,445 m€ in 99.9% of the cases.

It is clear that losses decrease moving from Scenario 1 to Scenario 2, and from Scenario 3 to Scenario 4, depending on the fact that contagion between banks is considered (Scenario 1 and 3) or not (Scenario 2 and 4). Moreover losses decrease when moving from a minimum capital ratio of 8% (Scenario 1 and 2) to a minimum capital ratio of 10.5% (Scenario 3 and 4).

5.2. Results for individual contributions to systemic losses

Tables 7-18 show some selected percentiles of the distribution of individual contributions to systemic losses. Tables 7-10 illustrate individual contributions for the **whole** set of cases (i.e. without considering cases where losses exceed or are below the amount of funds available to DGS/RF). Tables 11-14 illustrate individual contributions for cases where losses are **below** the amount of funds available to DGS/RF. Tables 15-18 finally illustrate individual contributions for cases where losses are **above** the amount of funds available to DGS/RF.

Figures should be read as in the following example. For Scenario 1 in Belgium the yearly expected loss is lower than 0.9134% for 75% of the banks in the sample. Average yearly individual contributions are usually much higher than the median, suggesting that there are few banks contributing most to the systemic risk.

This fact is also confirmed if we compute the Gini coefficient for the distributions of the individual contributions (whole, above and below) in each scenario and for all countries. The Gini coefficient measures the inequality of a distribution, so a value of 0 expresses total equality and a value of 1 maximal inequality.[12] Results are shown in Table 19 and plotted in the graphs of Figure 1 for comparison purposes.

By looking at these results it is possible to notice how the distributions of individual contributions to systemic risk tend to be rather concentrated. Concentration tends to increase when moving from the "below" to the "whole" and from the "whole" to be "above" individual contributions.

This is a not surprising results as bigger banks (less numerous) tend to relatively contribute more to higher systemic losses, while smaller banks (more numerous) tend to relatively contribute lower systemic losses.

[12] In our example a value of 0 would say that all banks contribute equally to the systemic losses while a value of 1 would say that there is a single bank responsible for the entire amount of systemic losses.

5.3. The FAT

Table 2 provides the coefficient of correlations between various types of FAT and various scenarios of systemic risk. Several messages stand out. First, when contagion is not avoided and DGS / Resolution Fund are not yet funded all versions of FAT perform in about the same way [contagion whole 8% scenario].

Suppose now that DGS / Resolution Fund are funded but that the legal framework for bank resolution is still unable to block contagion. Once again, all versions of FAT perform in about the same way [contagion above 8% scenario].Finally, consider that DGS / Resolution Fund are funded and that contagion can be avoided [no contagion above 8% scenario] In this case; FAT1 is more aligned to risk and provides the best incentive. This is not completely surprising as capital requirement require more equity when banks take more risks. If more risky activities produce high profits, part of them might be needed to remunerate the higher capital required.

It shall be stressed that FAT3 rests on the hypothesis that high returns are due to higher risks. While this could be true, other factors may trigger higher returns such as a lack of competition or more efficient production methods (e.g. superior knowledge of markets, a more productive workforce, mean management structures). In this latter case, the tax could be a tax on talent rather than a tax on high risk. In practice, Adrian and Brunnermeier (2010) find that the contribution of an individual institution to systemic risk is correlated with leverage, the relative size and maturity mismatch. As indicated in Table 2, FAT1 is the option that is best correlated with size, as measured by total assets.

Table 2. Correlation between individual contributions to FAT and Systemic Risk

	FAT1	**FAT2**	**FAT3**
Contagion - Whole - 8%	0.49	0.46	0.44
Contagion - Below - 8%	0.25	0.11	0.08
Contagion - Above - 8%	0.48	0.45	0.44
No Contagion - Whole - 8%	0.51	0.33	0.27
No Contagion - Below - 8%	0.43	0.28	0.22
No Contagion - Above - 8%	0.49	0.31	0.25
total assets	0.71	0.54	0.44

Note: taking FAT revenues adjusted for relocation and elasticities effects provide very similar results.

5.4. The FTT

The same exercise cannot be done for the FTT as there is no bank-level data on contribution to FTT. The aspects of dealing with risk and behavioural effects of the FTT related to the possibility of the FTT to curb speculation, noise trading and technical trade, and to decrease

markets' volatility. An extensive review of the economic literature in Hemmelgarn and Nicodème (2010) concludes that the effects of the FTT on volatility is largely inconclusive and depends on market structure. Several studies show that a FTT could even aggravate volatility (because of a reduction in the number of transactions), creating more room for speculators.

The simulations with a dynamic stochastic general equilibrium model presented in section 6.4.1 and Annex 15 show that a FTT impact on volatility would be very marginal while costs in terms of GDP will be relatively high. On the other hand, the FTT would serve as a tool to deal with the challenge of short-sighted profit-seeking behaviour. Also, it could help to reduce the rents of the financial sector generated by activities such as high-frequency automated trading.

Table 3: Estimated distributions of systemic excess losses in Scenario 1- Million Euro (Capital ≥ 8% RWA, No Bail-In, Contagion)

	90	95	96	97	98	99	99.5	99.9	99.95	99.99	99.995	99.999
BE	-	-	-	-	-	-	-	69,445	75,203	88,009	94,148	110,907
BG	-	-	-	-	-	-	-	56	144	451	830	1,817
DK	-	-	-	-	-	1	57	12,190	18,116	59,049	66,486	85,445
DE	-	11	25	54	128	436	1,255	321,017	388,965	464,719	494,974	575,736
GR	-	-	-	-	-	-	158	3,499	5,720	14,362	19,065	29,247
ES	-	-	-	-	2	146	1,348	14,860	30,581	79,267	105,814	164,196
FR	-	-	-	24	181	1,585	5,955	39,357	92,949	223,088	261,608	346,929
IE	-	-	-	-	-	-	787	68,848	77,334	91,954	97,964	113,956
IT	-	16	34	76	186	592	1,438	6,889	11,013	30,447	41,798	74,748
CY	-	-	-	-	-	-	-	19,573	21,463	23,632	24,464	26,382
LV	-	-	-	-	-	-	2	110	201	847	1,371	2,597
LU	-	-	-	-	-	-	-	50,776	60,553	74,228	77,739	85,326
MT	-	-	-	-	-	-	-	52	182	800	1,101	2,904
NL	-	-	-	-	-	-	5	24,275	129,948	157,113	168,784	198,370
AT	-	-	-	3	19	99	414	8,767	14,296	36,686	44,584	60,661
PT	-	-	-	-	-	-	67	6,924	12,988	23,435	27,773	37,992

FI	-	-	-	-	-	-	-	380	24,983	31,519	34,826	43,503
SE	-	-	-	-	-	-	-	69	9,780	58,346	65,067	79,655
UK	-	-	-	-	0	46	323	185,759	292,365	353,069	382,369	449,315

Table 4: Estimated distributions of systemic excess losses in Scenario 2 - Million Euro (Capital ≥ 8% RWA, No Bail-In, No Contagion)

	90	95	96	97	98	99	99.5	99.9	99.95	99.99	99.995	99.999
BE	-	-	-	-	-	-	-	3,626	6,813	15,926	20,747	34,157
BG	-	-	-	-	-	-	-	38	79	225	309	545
DK	-	-	-	-	-	1	49	1,698	3,464	10,191	14,051	26,281
DE	-	11	24	53	125	405	1,074	5,716	10,620	34,282	49,025	98,660
GR	-	-	-	-	-	-	106	1,897	3,217	6,995	8,948	14,842
ES	-	-	-	-	2	117	902	7,424	11,999	28,101	37,829	60,990
FR	-	-	-	23	166	1,182	4,251	19,393	30,235	63,643	83,061	132,007
IE	-	-	-	-	-	-	337	4,291	6,764	13,939	17,927	28,407
IT	-	16	34	74	180	560	1,340	5,854	9,313	22,234	31,288	51,638
CY	-	-	-	-	-	-	-	111	339	1,284	1,797	3,142
LV	-	-	-	-	-	-	1	60	107	253	327	556
LU	-	-	-	-	-	-	-	618	1,505	4,505	6,040	9,796
MT	-	-	-	-	-	-	-	16	118	455	636	1,129
NL	-	-	-	-	-	-	5	2,304	7,237	25,386	34,589	58,693
AT	-	-	-	3	18	86	279	2,134	3,603	7,639	9,533	15,123

PT	-	-	-	-	-	-	51	2,684	4,642	9,858	12,512	19,359
FI	-	-	-	-	-	-	-	144	1,809	8,125	11,336	19,874
SE	-	-	-	-	-	-	-	66	1,965	9,983	14,103	25,154
UK	-	-	-	-	0	43	269	8,136	18,270	53,579	72,394	128,850

Table 5: Estimated distributions of systemic excess losses in Scenario 3- Million Euro (Capital ≥ 10.5% RWA, No Bail-In , Contagion)

	90	95	96	97	98	99	99.5	99.9	99.95	99.99	99.995	99.999
BE	-	-	-	-	-	-	-	15,509	63,852	79,753	86,050	102,517
BG	-	-	-	-	-	-	-	55	143	449	808	1,813
DK	-	-	-	-	-	-	17	1,525	12,677	53,523	61,735	80,107
DE	-	6	16	38	95	318	917	12,370	370,337	455,300	484,531	565,109
GR	-	-	-	-	-	-	-	1,382	2,940	8,065	11,175	20,790
ES	-	-	-	-	0	65	471	10,507	24,720	65,275	85,791	141,078
FR	-	-	-	1	45	330	1,373	14,891	28,204	95,974	157,523	260,554
IE	-	-	-	-	-	-	-	8,699	46,159	77,618	84,660	101,801
IT	-	-	2	11	40	204	636	4,056	7,281	22,128	33,045	56,190
CY	-	-	-	-	-	-	-	19,359	21,371	23,585	24,427	26,320
LV	-	-	-	-	-	-	-	52	128	597	968	2,279
LU	-	-	-	-	-	-	-	757	52,376	71,921	75,799	83,630
MT	-	-	-	-	-	-	-	5	147	760	1,051	2,827
NL	-	-	-	-	-	-	-	9,773	72,722	151,571	163,275	192,763
AT	-	-	-	-	9	60	211	2,322	4,555	17,751	31,780	53,248

PT	-	-	-	-	-	-	-	2,143	5,351	14,086	18,440	28,193
FI	-	-	-	-	-	-	-	4	1,058	29,373	32,648	41,363
SE	-	-	-	-	-	-	-	45	8,710	53,712	62,356	77,536
UK	-	-	-	-	-	9	96	38,574	166,950	306,174	337,066	401,732

Table 6: Estimated distributions of systemic excess losses in Scenario 4 - Million Euro (Capital ≥ 10.5% RWA, No Bail-In, No Contagion)

	90	95	96	97	98	99	99.5	99.9	99.95	99.99	99.995	99.999
BE	-	-	-	-	-	-	-	1,001	4,076	12,938	17,701	30,398
BG	-	-	-	-	-	-	-	37	78	223	306	543
DK	-	-	-	-	-	-	16	981	2,470	9,083	12,975	24,947
DE	-	6	16	38	93	301	809	4,885	9,623	33,852	47,704	100,895
GR	-	-	-	-	-	-	-	767	1,776	5,184	7,069	11,801
ES	-	-	-	-	0	56	383	5,057	9,368	25,575	34,404	57,558
FR	-	-	-	1	44	307	1,148	10,230	18,085	45,269	60,498	99,316
IE	-	-	-	-	-	-	-	2,016	4,120	10,610	14,284	24,026
IT	-	-	2	11	40	196	597	3,514	6,251	17,605	25,427	43,833
CY	-	-	-	-	-	-	-	107	330	1,274	1,794	3,116
LV	-	-	-	-	-	-	-	30	66	199	272	496
LU	-	-	-	-	-	-	-	308	751	3,006	4,453	8,105
MT	-	-	-	-	-	-	-	3	88	432	610	1,112
NL	-	-	-	-	-	-	-	1,642	5,586	22,034	30,741	54,775
AT	-	-	-	-	9	55	172	1,288	2,383	5,954	7,825	13,101

PT	-	-	-	-	-	-	-	638	2,133	6,912	9,297	15,739
FI	-	-	-	-	-	-	-	3	433	5,988	9,166	17,731
SE	-	-	-	-	-	-	-	44	893	8,735	12,617	23,363
UK	-	-	-	-	-	8	89	2,330	7,835	37,386	54,891	105,561

Table 7: Distributions of individual banks' percentage contributions – whole – Scenario 1 (Capital ≥ 8% RWA, No Bail-In, Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0022%	0.0043%	0.0281%	0.9134%	17.1142%	26.1647%	37.9596%	4.3478%
BG	0.0877%	0.3010%	1.6317%	4.7369%	9.1465%	16.7407%	26.8025%	4.1667%
DK	0.0002%	0.0012%	0.0049%	0.0273%	0.1820%	3.0450%	26.6287%	1.0101%
DE	0.0002%	0.0008%	0.0026%	0.0080%	0.0257%	0.0576%	0.5994%	0.0675%
GR	0.1415%	0.3639%	0.8895%	7.1380%	17.3577%	23.1515%	35.9771%	6.2500%
ES	0.0018%	0.0046%	0.0314%	0.1644%	1.1811%	2.9237%	10.8990%	0.6993%
FR	0.0025%	0.0068%	0.0282%	0.0764%	0.5760%	2.3732%	9.5176%	0.5128%
IE	0.0014%	0.0157%	0.3075%	3.5338%	8.1870%	17.6855%	37.8607%	4.1667%
IT	0.0015%	0.0071%	0.0256%	0.0922%	0.3491%	0.6314%	3.9744%	0.2114%
CY	0.0077%	0.2077%	0.6766%	8.5586%	12.2505%	23.4636%	40.7975%	6.6667%
LV	0.2258%	0.8302%	2.7152%	7.7833%	8.3205%	8.7403%	23.8506%	4.7619%
LU	0.0334%	0.1538%	0.5123%	1.3600%	3.8738%	5.8616%	20.3512%	1.7857%
MT	0.0382%	0.3323%	1.0173%	10.7441%	34.3410%	41.6739%	47.5401%	10.0000%
NL	0.0174%	0.0478%	0.0872%	0.2099%	23.0060%	33.6746%	37.4938%	4.7619%
AT	0.0114%	0.0250%	0.0533%	0.1371%	0.6454%	2.5922%	6.2619%	0.5780%
PT	0.0706%	0.1978%	0.8752%	2.5135%	29.0670%	36.5734%	39.5154%	7.1429%
FI	0.0015%	0.0095%	0.2253%	1.7176%	22.1164%	56.9913%	84.8912%	11.1111%
SE	0.0009%	0.0020%	0.0047%	0.0179%	0.0407%	0.5504%	33.2243%	1.5152%
UK	0.0010%	0.0028%	0.0167%	0.0850%	1.1244%	1.6885%	31.6956%	1.1765%

Table 8: Distributions of individual banks' percentage contributions – whole – Scenario 2 (Capital ≥ 8% RWA, No Bail-In, No Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0078%	0.0208%	0.0427%	0.1656%	23.1840%	32.6450%	35.8473%	4.3478%
BG	0.1309%	0.5011%	2.7339%	4.6498%	10.4491%	16.0674%	18.7685%	4.1667%

DK	0.0004%	0.0026%	0.0178%	0.0766%	0.5481%	6.2852%	31.0633%	2.0000%
DE	0.0009%	0.0032%	0.0107%	0.0308%	0.0714%	0.1350%	0.9875%	0.0675%
GR	0.2203%	0.4663%	1.5785%	7.0135%	20.0000%	22.9969%	28.4450%	6.2500%
ES	0.0009%	0.0038%	0.0347%	0.1716%	0.6734%	4.3234%	12.8648%	0.6993%
FR	0.0045%	0.0092%	0.0490%	0.1158%	0.4310%	2.9426%	11.1523%	0.5128%
IE	0.0007%	0.0110%	0.0627%	3.7445%	17.6680%	20.7172%	22.4775%	4.1667%
IT	0.0016%	0.0080%	0.0286%	0.1028%	0.3851%	0.6830%	3.0177%	0.2114%
CY	0.2294%	0.6473%	1.5616%	6.6511%	20.9144%	28.9569%	33.9570%	6.6667%
LV	0.0036%	0.5580%	1.1622%	4.5207%	9.9036%	18.7625%	33.0925%	4.7619%
LU	0.0238%	0.0505%	0.1845%	0.6787%	2.3391%	3.9141%	81.6590%	3.5088%
MT	0.0291%	0.0473%	0.3704%	3.5151%	43.1600%	47.0231%	50.1135%	10.0000%
NL	0.0955%	0.1387%	0.2119%	0.9933%	18.7878%	19.3270%	44.6077%	4.7619%
AT	0.0288%	0.0618%	0.1096%	0.2598%	0.8464%	1.6975%	8.9955%	0.5780%
PT	0.0718%	0.1697%	0.6795%	3.8920%	29.5305%	31.9445%	32.9386%	7.1429%
FI	0.0099%	0.0412%	0.2377%	1.1698%	21.7191%	58.0918%	87.1899%	11.1111%
SE	0.0040%	0.0069%	0.0159%	0.0404%	0.1094%	0.2022%	36.6290%	1.5152%
UK	0.0027%	0.0083%	0.0285%	0.1546%	1.1078%	5.7536%	18.6160%	1.1765%

Table 9: Distributions of individual banks' percentage contributions – whole – Scenario 3 (Capital ≥ 10.5% RWA, No Bail-In, Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0046%	0.0096%	0.0410%	0.9420%	13.6335%	29.1879%	38.7886%	4.3478%
BG	0.0886%	0.3058%	1.5705%	4.7789%	8.8080%	16.8323%	27.0385%	4.1667%
DK	0.0003%	0.0017%	0.0069%	0.0338%	0.2243%	2.4940%	35.7049%	1.0101%
DE	0.0002%	0.0008%	0.0026%	0.0078%	0.0257%	0.0573%	0.5911%	0.0675%
GR	0.2547%	0.5217%	0.8674%	8.4102%	20.6547%	27.0478%	27.0903%	6.2500%
ES	0.0020%	0.0055%	0.0393%	0.2127%	1.2631%	3.2610%	11.6907%	0.6993%
FR	0.0056%	0.0130%	0.0612%	0.1589%	0.5735%	2.0863%	10.6079%	0.5128%
IE	0.0027%	0.0208%	0.3548%	3.7614%	8.0188%	19.0723%	36.4371%	4.1667%
IT	0.0024%	0.0087%	0.0224%	0.0821%	0.3687%	0.6857%	4.3992%	0.2114%
CY	0.0078%	0.1963%	0.5930%	8.5792%	12.3248%	23.5748%	40.9062%	6.6667%
LV	0.2455%	0.9949%	3.3307%	6.8224%	12.4977%	12.8572%	15.7057%	4.7619%
LU	0.0450%	0.1626%	0.5560%	1.4681%	3.9372%	6.2815%	19.0453%	1.7857%
MT	0.0466%	0.3711%	1.1522%	12.2141%	38.0873%	39.8161%	41.1991%	10.0000%
NL	0.0208%	0.0517%	0.0873%	0.2065%	19.4624%	35.1472%	39.3204%	4.7619%
AT	0.0205%	0.0426%	0.0959%	0.2171%	1.0754%	3.0780%	10.2694%	0.5780%
PT	0.0835%	0.1188%	0.8867%	2.7932%	27.9849%	35.2887%	39.0414%	7.1429%
FI	0.0027%	0.0176%	0.3807%	1.7054%	22.4382%	56.7157%	84.1377%	11.1111%
SE	0.0012%	0.0024%	0.0058%	0.0216%	0.0474%	0.5707%	33.3885%	1.5152%
UK	0.0010%	0.0042%	0.0197%	0.0834%	1.3876%	2.1093%	30.0370%	1.1765%

Table 10: Distributions of individual banks' percentage contributions – whole – Scenario 4 (Capital ≥ 10.5% RWA, No Bail-In, No Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0142%	0.0376%	0.0770%	0.2976%	21.9626%	28.8249%	38.4729%	4.3478%
BG	0.1334%	0.4796%	2.6567%	4.7079%	10.6112%	15.4658%	18.8470%	4.1667%

DK	0.0006%	0.0037%	0.0247%	0.0956%	0.6532%	5.4959%	20.6808%	1.0101%
DE	0.0010%	0.0036%	0.0120%	0.0329%	0.0768%	0.1352%	0.6885%	0.0675%
GR	0.3738%	0.6992%	1.2947%	9.4604%	17.5372%	21.8318%	27.3389%	6.2500%
ES	0.0014%	0.0056%	0.0487%	0.2526%	1.0110%	3.6859%	12.8974%	0.6993%
FR	0.0081%	0.0177%	0.0950%	0.2153%	0.5080%	2.5727%	8.5546%	0.5128%
IE	0.0011%	0.0228%	0.1321%	5.0397%	16.7615%	17.2005%	23.5855%	4.1667%
IT	0.0027%	0.0098%	0.0256%	0.0888%	0.3776%	0.7431%	3.5207%	0.2114%
CY	0.2487%	0.6067%	1.0305%	6.7877%	20.9855%	29.2661%	35.2996%	6.6667%
LV	0.0055%	0.7219%	1.6959%	6.5930%	14.8804%	15.7135%	20.7510%	4.7619%
LU	0.0407%	0.0862%	0.3135%	1.1400%	3.4968%	4.8710%	25.7367%	1.7857%
MT	0.0362%	0.0570%	0.4383%	4.1275%	43.3420%	46.3264%	48.7140%	10.0000%
NL	0.1176%	0.1720%	0.2577%	1.0045%	22.9457%	23.7061%	37.1041%	4.7619%
AT	0.0324%	0.0755%	0.1487%	0.3395%	0.9014%	2.3034%	10.6295%	0.5780%
PT	0.0898%	0.1854%	0.6429%	5.4522%	27.9206%	30.7674%	32.6901%	7.1429%
FI	0.0170%	0.0722%	0.4035%	2.0173%	22.9504%	56.7170%	83.7303%	11.1111%
SE	0.0051%	0.0088%	0.0204%	0.0519%	0.1412%	0.2612%	36.9101%	1.5152%
UK	0.0030%	0.0099%	0.0360%	0.2270%	1.6814%	4.4904%	19.5571%	1.1765%

Table 11: Distributions of individual banks' percentage contributions – below – Scenario 1 (Capital ≥ 8% RWA, No Bail-In, Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0500%	0.6944%	1.9526%	7.0065%	11.1666%	14.8967%	18.1460%	4.3478%
BG	0.1257%	0.4972%	2.8542%	4.9823%	10.1894%	13.9204%	20.3940%	4.1667%
DK	0.0008%	0.0054%	0.0351%	0.1610%	1.1725%	3.9017%	21.5494%	1.0101%
DE	0.0009%	0.0036%	0.0126%	0.0367%	0.0883%	0.1580%	1.0371%	0.0675%
GR	0.4080%	0.8874%	3.0304%	9.8364%	15.9143%	19.3363%	22.2263%	6.2500%
ES	0.0013%	0.0054%	0.0434%	0.3497%	0.9770%	4.6611%	12.4304%	0.6993%
FR	0.0049%	0.0106%	0.0546%	0.1349%	0.5488%	3.6944%	7.6902%	0.5128%
IE	0.0000%	0.0088%	0.0902%	4.8263%	18.1755%	20.0997%	20.2689%	4.1667%
IT	0.0016%	0.0086%	0.0318%	0.1077%	0.3972%	0.7584%	3.5832%	0.2114%
CY	0.0000%	0.0000%	0.6520%	8.3994%	22.9105%	28.8259%	32.9143%	6.6667%
LV	0.0000%	0.6777%	1.9519%	5.6490%	8.1576%	22.8133%	24.1175%	4.7619%
LU	0.0229%	0.1282%	0.5276%	1.3640%	4.5993%	7.9418%	16.9371%	1.7857%
MT	0.0383%	0.1499%	0.2886%	6.4203%	24.6879%	46.8324%	64.5479%	10.0000%
NL	0.0000%	0.8558%	1.5079%	3.6586%	9.1961%	16.3678%	37.2062%	4.7619%
AT	0.0382%	0.0821%	0.1510%	0.3662%	1.5952%	2.7490%	6.7230%	0.5780%
PT	0.0153%	1.0787%	2.5574%	7.1967%	23.6501%	25.1234%	25.3186%	7.1429%
FI	0.1212%	0.2109%	1.4756%	10.2906%	25.2072%	45.4432%	61.6320%	11.1111%
SE	0.1083%	0.2772%	0.6648%	1.7538%	3.9407%	5.5128%	9.3669%	1.5152%
UK	0.0012%	0.0263%	0.1133%	0.4458%	1.7519%	3.9454%	18.3630%	1.1765%

Table 12: Distributions of individual banks' percentage contributions – below – Scenario 2 (Capital ≥ 8% RWA, No Bail-In, No Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0342%	0.0927%	0.1872%	0.7309%	16.7226%	33.0464%	37.7922%	4.3478%
BG	0.1497%	0.5912%	3.1411%	5.0624%	10.7537%	15.5967%	16.9262%	4.1667%

DK	0.0008%	0.0052%	0.0381%	0.1528%	1.2147%	9.8273%	23.5538%	2.0000%
DE	0.0009%	0.0035%	0.0120%	0.0343%	0.0797%	0.1520%	1.1205%	0.0675%
GR	0.4374%	0.9271%	3.2891%	9.2740%	17.4012%	19.1305%	19.8559%	6.2500%
ES	0.0013%	0.0054%	0.0483%	0.2434%	0.9441%	5.2025%	12.6388%	0.6993%
FR	0.0058%	0.0126%	0.0645%	0.1485%	0.5753%	3.7778%	8.7251%	0.5128%
IE	0.0004%	0.0197%	0.1253%	7.5119%	14.9949%	15.1656%	15.7374%	4.1667%
IT	0.0018%	0.0092%	0.0335%	0.1146%	0.4155%	0.8057%	2.7999%	0.2114%
CY	0.4368%	1.1990%	3.1584%	11.2555%	17.3248%	18.3855%	20.2143%	6.6667%
LV	0.0063%	1.0533%	2.1449%	4.6691%	16.5334%	17.9649%	22.1794%	4.7619%
LU	0.0462%	0.0915%	0.3689%	1.2526%	3.3899%	7.5775%	68.5972%	3.5088%
MT	0.0930%	0.1902%	1.5330%	7.4777%	26.2422%	43.4285%	57.1775%	10.0000%
NL	0.3413%	0.4918%	0.7545%	3.5986%	19.8124%	20.8555%	22.2238%	4.7619%
AT	0.0417%	0.0905%	0.1580%	0.3677%	1.2419%	2.3550%	6.0227%	0.5780%
PT	0.3061%	0.7257%	2.8978%	14.1144%	19.4343%	20.2880%	21.5149%	7.1429%
FI	0.0965%	0.3997%	2.3415%	6.9243%	30.5981%	46.1596%	58.6088%	11.1111%
SE	0.0264%	0.0484%	0.1104%	0.2828%	0.7804%	1.4406%	31.1609%	1.5152%
UK	0.0049%	0.0177%	0.0645%	0.3460%	2.5346%	9.7633%	15.1320%	1.1765%

Table 13: Distributions of individual banks' percentage contributions – below – Scenario 3 (Capital ≥ 10.5% RWA, No Bail-In, Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0552%	0.7211%	1.9176%	6.9041%	11.2506%	15.1657%	18.1472%	4.3478%
BG	0.1281%	0.5051%	2.7501%	5.0547%	10.1415%	13.3322%	20.4863%	4.1667%
DK	0.0012%	0.0079%	0.0502%	0.2349%	1.1822%	5.3300%	17.9043%	1.0101%
DE	0.0012%	0.0045%	0.0155%	0.0431%	0.0992%	0.1745%	0.6837%	0.0675%
GR	0.6840%	1.3216%	2.4195%	12.8920%	16.4081%	17.0744%	17.5459%	6.2500%
ES	0.0021%	0.0090%	0.0693%	0.5357%	1.7546%	4.3971%	8.6366%	0.6993%
FR	0.0095%	0.0217%	0.1105%	0.2721%	0.6167%	3.0263%	6.9423%	0.5128%
IE	0.0000%	0.0229%	0.2209%	5.6806%	14.9391%	17.4807%	17.9009%	4.1667%
IT	0.0031%	0.0115%	0.0293%	0.1051%	0.4372%	0.8283%	4.7561%	0.2114%
CY	0.0000%	0.0000%	0.8997%	8.2409%	14.8677%	24.3596%	41.9002%	6.6667%
LV	0.0000%	1.2346%	3.1006%	7.2371%	11.0047%	13.5662%	14.5907%	4.7619%
LU	0.0226%	0.1291%	0.5569%	1.3411%	4.4667%	8.5567%	17.0568%	1.7857%
MT	0.0572%	0.2156%	0.4449%	8.4288%	29.8138%	44.1036%	55.5355%	10.0000%
NL	0.0000%	0.8885%	1.4287%	3.8481%	7.2559%	17.0093%	38.7579%	4.7619%
AT	0.0320%	0.0801%	0.1613%	0.3913%	1.5604%	3.3502%	5.6286%	0.5780%
PT	0.0417%	0.6874%	1.4760%	8.2660%	22.2463%	26.4136%	30.0514%	7.1429%
FI	0.1233%	0.2093%	1.4849%	10.2139%	25.0556%	45.4790%	61.8176%	11.1111%
SE	0.1114%	0.2774%	0.6588%	1.8348%	3.9308%	5.4931%	9.3030%	1.5152%
UK	0.0011%	0.0277%	0.1197%	0.4490%	2.1103%	6.8544%	16.3834%	1.1765%

Table 14: Distributions of individual banks' percentage contributions – below – Scenario 4 (Capital ≥ 10.5% RWA, No Bail-In, No Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0746%	0.1933%	0.3971%	1.5645%	21.5170%	26.5793%	32.2916%	4.3478%
BG	0.1531%	0.5683%	3.0376%	5.1493%	10.8547%	15.7103%	16.5536%	4.1667%

DK	0.0013%	0.0080%	0.0562%	0.2248%	1.5222%	8.4901%	13.8853%	1.0101%
DE	0.0011%	0.0041%	0.0141%	0.0384%	0.0882%	0.1572%	0.7826%	0.0675%
GR	0.7645%	1.4364%	2.6978%	13.1138%	13.7808%	14.5635%	15.7385%	6.2500%
ES	0.0021%	0.0087%	0.0757%	0.3878%	1.5195%	5.3578%	8.8839%	0.6993%
FR	0.0109%	0.0229%	0.1272%	0.2893%	0.6809%	3.2436%	6.8008%	0.5128%
IE	0.0011%	0.0476%	0.2993%	10.4917%	12.0406%	14.0974%	15.8043%	4.1667%
IT	0.0033%	0.0120%	0.0311%	0.1088%	0.4357%	0.8660%	4.1128%	0.2114%
CY	0.4852%	1.2278%	2.1099%	11.6133%	18.1775%	19.6476%	21.6274%	6.6667%
LV	0.0100%	1.4562%	2.4497%	8.1016%	11.0760%	12.1185%	12.7322%	4.7619%
LU	0.0647%	0.1306%	0.5091%	1.7337%	4.1579%	6.0628%	18.5164%	1.7857%
MT	0.1270%	0.2534%	1.9623%	9.4286%	30.5166%	40.3470%	48.2113%	10.0000%
NL	0.3758%	0.5449%	0.8236%	3.0795%	15.7495%	22.9539%	24.4704%	4.7619%
AT	0.0431%	0.0986%	0.2029%	0.4486%	1.1827%	2.7780%	6.3390%	0.5780%
PT	0.3676%	0.7610%	2.6266%	14.9285%	18.4133%	19.1398%	20.0689%	7.1429%
FI	0.1431%	0.6146%	3.4837%	10.1536%	35.6567%	39.5336%	42.6352%	11.1111%
SE	0.0336%	0.0609%	0.1393%	0.3561%	0.9838%	1.8125%	30.0749%	1.5152%
UK	0.0063%	0.0216%	0.0790%	0.4950%	3.6832%	8.8667%	12.0785%	1.1765%

Table 15: Distributions of individual banks' percentage contributions – above– Scenario 1 - (Capital ≥ 8% RWA, No Bail-In, Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0011%	0.0018%	0.0180%	0.9056%	17.1268%	26.1882%	37.9938%	4.3478%
BG	0.0491%	0.1217%	0.4360%	3.2527%	7.0954%	27.5938%	35.3327%	4.1667%
DK	0.0001%	0.0004%	0.0028%	0.0176%	0.0952%	1.7208%	28.4990%	1.0101%
DE	0.0001%	0.0004%	0.0015%	0.0061%	0.0229%	0.0537%	0.6115%	0.0675%
GR	0.0624%	0.1908%	0.2891%	4.7283%	17.9277%	26.6728%	43.7104%	6.2500%
ES	0.0015%	0.0035%	0.0208%	0.0769%	1.0781%	3.3384%	12.9602%	0.6993%
FR	0.0015%	0.0044%	0.0153%	0.0481%	0.4765%	1.7195%	9.7020%	0.5128%
IE	0.0010%	0.0149%	0.2506%	3.5274%	8.2412%	18.1093%	38.7684%	4.1667%
IT	0.0010%	0.0039%	0.0117%	0.0444%	0.2169%	0.3664%	4.7795%	0.2114%
CY	0.0043%	0.1797%	0.6440%	8.5693%	12.2658%	23.4931%	40.8488%	6.6667%
LV	0.1186%	0.8652%	2.5244%	6.0575%	9.8138%	10.2346%	24.7355%	4.7619%
LU	0.0274%	0.1338%	0.4899%	1.3599%	3.8662%	5.9003%	20.4430%	1.7857%
MT	0.0264%	0.2114%	0.8921%	12.0968%	35.6354%	40.9822%	45.2597%	10.0000%
NL	0.0091%	0.0206%	0.0626%	0.1931%	23.2300%	34.0025%	37.8589%	4.7619%
AT	0.0049%	0.0111%	0.0252%	0.0730%	0.4488%	2.3576%	6.2599%	0.5780%
PT	0.0158%	0.0798%	0.6773%	2.1575%	30.0244%	38.2053%	41.2786%	7.1429%
FI	0.0005%	0.0015%	0.1437%	1.7219%	21.9494%	57.1599%	85.3283%	11.1111%
SE	0.0002%	0.0005%	0.0012%	0.0041%	0.0202%	0.5430%	33.3515%	1.5152%
UK	0.0006%	0.0016%	0.0106%	0.0691%	1.0399%	1.6549%	31.9988%	1.1765%

Table 16: Distributions of individual banks' percentage contributions – above– Scenario 2 - (Capital ≥ 8% RWA, No Bail-In, No Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0023%	0.0050%	0.0111%	0.0416%	21.4225%	34.8838%	36.8245%	4.3478%
BG	0.0518%	0.1280%	0.9401%	2.8203%	13.7442%	22.7438%	30.0104%	4.1667%

DK	0.0002%	0.0008%	0.0038%	0.0153%	0.1081%	2.5118%	37.3744%	2.0000%
DE	0.0003%	0.0012%	0.0040%	0.0111%	0.0252%	0.0488%	0.2606%	0.0675%
GR	0.0588%	0.1132%	0.3054%	4.1836%	24.1743%	29.8259%	36.3478%	6.2500%
ES	0.0004%	0.0014%	0.0124%	0.0660%	0.2802%	2.0308%	18.1704%	0.6993%
FR	0.0021%	0.0039%	0.0227%	0.0541%	0.1841%	1.4909%	15.4365%	0.5128%
IE	0.0006%	0.0057%	0.0295%	1.5782%	19.1163%	24.0815%	26.9161%	4.1667%
IT	0.0011%	0.0047%	0.0139%	0.0491%	0.1842%	0.3668%	2.9448%	0.2114%
CY	0.0423%	0.0957%	0.2287%	3.3673%	22.9011%	39.4325%	49.0457%	6.6667%
LV	0.0017%	0.1385%	0.2704%	2.4548%	11.3724%	20.4006%	41.3220%	4.7619%
LU	0.0055%	0.0171%	0.0471%	0.1659%	1.0780%	2.2706%	92.3193%	3.5088%
MT	0.0074%	0.0188%	0.0943%	2.9475%	47.1783%	47.8769%	48.4357%	10.0000%
NL	0.0118%	0.0188%	0.0284%	0.1587%	18.0885%	18.2315%	52.8076%	4.7619%
AT	0.0100%	0.0202%	0.0421%	0.0885%	0.2769%	0.8590%	13.7734%	0.5780%
PT	0.0125%	0.0292%	0.1162%	1.3076%	31.8970%	35.1085%	36.3662%	7.1429%
FI	0.0018%	0.0073%	0.0390%	0.6261%	20.8803%	59.2190%	89.8900%	11.1111%
SE	0.0006%	0.0009%	0.0020%	0.0050%	0.0131%	0.0213%	37.4308%	1.5152%
UK	0.0005%	0.0016%	0.0051%	0.0277%	0.1619%	3.0956%	21.2252%	1.1765%

Table 17: Distributions of individual banks' percentage contributions – above– Scenario 3 (Capital ≥ 10.5% RWA, No Bail-In, Contagion)

	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0018%	0.0029%	0.0247%	0.9218%	13.6582%	29.2563%	38.8794%	4.3478%
BG	0.0490%	0.1231%	0.4352%	3.2564%	7.0590%	27.7505%	35.5091%	4.1667%
DK	0.0001%	0.0004%	0.0030%	0.0183%	0.1048%	1.2574%	38.6095%	1.0101%
DE	0.0001%	0.0004%	0.0015%	0.0058%	0.0219%	0.0530%	0.6027%	0.0675%
GR	0.0791%	0.1505%	0.2405%	5.0246%	23.5852%	33.8856%	35.5169%	6.2500%
ES	0.0015%	0.0034%	0.0214%	0.0795%	0.9059%	3.4840%	14.4479%	0.6993%
FR	0.0021%	0.0058%	0.0232%	0.0650%	0.4616%	1.3899%	12.2713%	0.5128%
IE	0.0020%	0.0163%	0.2390%	3.2924%	8.2831%	19.8526%	37.9297%	4.1667%
IT	0.0010%	0.0033%	0.0081%	0.0303%	0.1370%	0.3392%	3.4989%	0.2114%
CY	0.0043%	0.1705%	0.5796%	8.5873%	12.3365%	23.5971%	40.9450%	6.6667%
LV	0.0751%	0.9415%	2.7567%	6.8435%	15.2856%	15.7253%	16.7882%	4.7619%
LU	0.0370%	0.1633%	0.5565%	1.4561%	3.9146%	6.3714%	19.2121%	1.7857%
MT	0.0302%	0.2303%	0.9645%	13.5500%	39.0615%	39.3113%	39.5112%	10.0000%
NL	0.0098%	0.0187%	0.0627%	0.1843%	19.7024%	35.5807%	39.8053%	4.7619%
AT	0.0089%	0.0184%	0.0444%	0.1178%	0.6107%	2.5591%	13.4873%	0.5780%
PT	0.0133%	0.0419%	0.5711%	2.1107%	29.5120%	37.6823%	41.6895%	7.1429%
FI	0.0007%	0.0019%	0.2257%	1.7132%	22.1135%	57.0411%	84.9831%	11.1111%
SE	0.0002%	0.0005%	0.0013%	0.0046%	0.0213%	0.5597%	33.5551%	1.5152%
UK	0.0006%	0.0018%	0.0115%	0.0685%	1.2093%	2.1322%	30.6616%	1.1765%

Table 18: Distributions of individual banks' percentage contributions – above– Scenario 4 (Capital ≥ 10.5% RWA, No Bail-In, No Contagion)

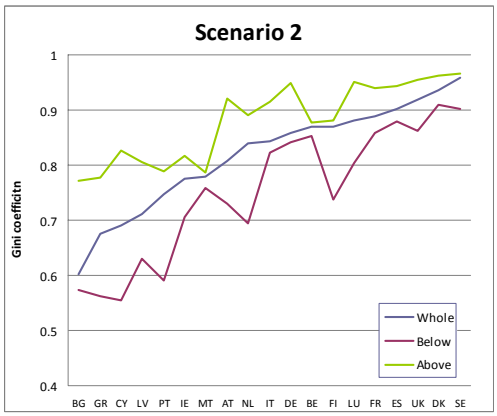
	Selected percentiles							
	10	**25**	**50**	**75**	**90**	**95**	**99**	**average**
BE	0.0032%	0.0069%	0.0145%	0.0482%	20.8550%	29.1715%	40.8218%	4.3478%
BG	0.0500%	0.1366%	0.9415%	2.7764%	13.3302%	22.8366%	30.2751%	4.1667%

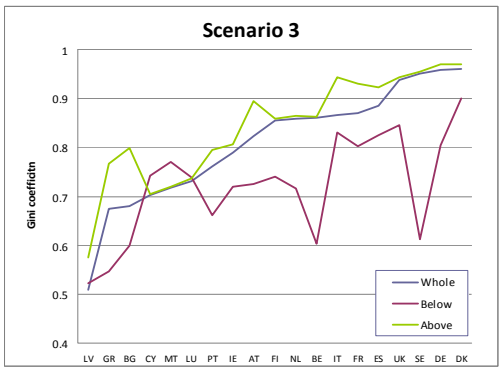
DK	0.0002%	0.0008%	0.0042%	0.0148%	0.0886%	1.6226%	25.1277%	1.0101%
DE	0.0003%	0.0012%	0.0036%	0.0101%	0.0240%	0.0428%	0.2661%	0.0675%
GR	0.0647%	0.1198%	0.2152%	5.5339%	21.4015%	29.3842%	38.5020%	6.2500%
ES	0.0004%	0.0015%	0.0131%	0.0695%	0.3016%	1.3628%	20.5355%	0.6993%
FR	0.0024%	0.0052%	0.0305%	0.0655%	0.1820%	1.1511%	12.9775%	0.5128%
IE	0.0008%	0.0099%	0.0396%	1.8999%	18.6573%	20.4367%	29.2582%	4.1667%
IT	0.0011%	0.0038%	0.0094%	0.0360%	0.1357%	0.3331%	2.9495%	0.2114%
CY	0.0436%	0.0710%	0.2306%	3.3326%	22.3644%	39.0958%	49.8394%	6.6667%
LV	0.0018%	0.1259%	0.3071%	4.0332%	18.0090%	20.6281%	28.1577%	4.7619%
LU	0.0088%	0.0230%	0.0730%	0.2885%	1.5448%	4.2534%	36.1708%	1.7857%
MT	0.0081%	0.0208%	0.1045%	3.4015%	42.3235%	48.1144%	52.7471%	10.0000%
NL	0.0146%	0.0217%	0.0329%	0.1802%	22.9425%	23.2517%	45.6179%	4.7619%
AT	0.0119%	0.0241%	0.0478%	0.1089%	0.3643%	1.2339%	17.1599%	0.5780%
PT	0.0113%	0.0228%	0.0836%	1.6906%	31.2654%	34.8406%	36.8164%	7.1429%
FI	0.0025%	0.0093%	0.0484%	1.0795%	21.4859%	58.6975%	88.4668%	11.1111%
SE	0.0006%	0.0009%	0.0022%	0.0058%	0.0145%	0.0246%	37.9525%	1.5152%
UK	0.0004%	0.0015%	0.0052%	0.0285%	0.1989%	2.1618%	23.7258%	1.1765%

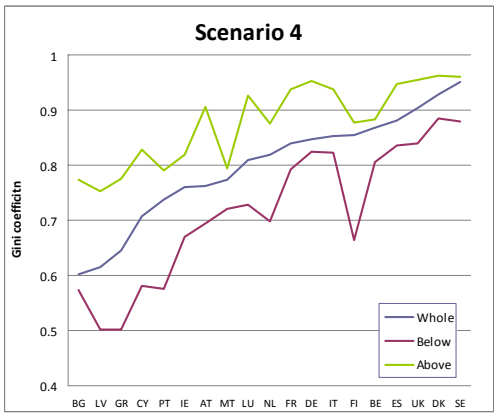
Table 19: Gini coefficients for the distributions of banks' individual percentage contribution in each scenario and for each country.

5.4.1.	*5.4.2.*	*Scenario 1*		*5.4.3.*	*Scenario 2*		*5.4.4.*	*Scenario 3*		*5.4.5.*	*Scenario 4*	
	Whole	**Below**	**Above**	**Whole**	**Below**	**Above**	**Whole**	**Below**	**Above**	**Whole**	**Below**	**Above**
BE	0.858	0.604	0.859	0.869	0.852	0.877	0.860	0.604	0.862	0.868	0.805	0.883
BG	0.679	0.601	0.796	0.601	0.574	0.772	0.681	0.600	0.798	0.601	0.574	0.773
DK	0.964	0.921	0.971	0.936	0.910	0.962	0.960	0.901	0.969	0.929	0.885	0.963
DE	0.958	0.832	0.968	0.859	0.842	0.949	0.958	0.804	0.969	0.848	0.825	0.953
GR	0.716	0.574	0.779	0.675	0.563	0.777	0.675	0.546	0.766	0.646	0.502	0.775
ES	0.893	0.874	0.917	0.901	0.879	0.943	0.885	0.825	0.923	0.882	0.835	0.948
FR	0.911	0.868	0.934	0.888	0.859	0.940	0.871	0.803	0.930	0.839	0.792	0.937
IE	0.803	0.759	0.812	0.775	0.706	0.817	0.790	0.720	0.807	0.761	0.670	0.819
IT	0.856	0.830	0.921	0.844	0.823	0.915	0.866	0.830	0.943	0.853	0.823	0.938
CY	0.700	0.738	0.702	0.691	0.554	0.826	0.703	0.742	0.704	0.708	0.581	0.829
LV	0.558	0.627	0.595	0.711	0.630	0.805	0.510	0.523	0.574	0.615	0.502	0.752
LU	0.749	0.739	0.753	0.882	0.803	0.951	0.731	0.739	0.737	0.810	0.729	0.927
MT	0.740	0.804	0.739	0.780	0.759	0.786	0.718	0.771	0.719	0.773	0.721	0.795
NL	0.854	0.713	0.859	0.840	0.695	0.890	0.859	0.716	0.865	0.818	0.698	0.875
AT	0.886	0.728	0.926	0.807	0.730	0.920	0.824	0.725	0.895	0.763	0.695	0.906
PT	0.769	0.628	0.791	0.748	0.591	0.789	0.762	0.662	0.795	0.738	0.575	0.790
FI	0.858	0.740	0.861	0.869	0.738	0.881	0.855	0.740	0.859	0.855	0.665	0.877
SE	0.956	0.614	0.958	0.958	0.901	0.966	0.952	0.613	0.954	0.951	0.879	0.961
UK	0.942	0.865	0.946	0.918	0.863	0.955	0.938	0.846	0.944	0.904	0.840	0.955

***Figure 1**: Gini coefficient in the various scenarios.*







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ANNEX A: Description of the sample of banks for the SYMBOL simulations

***Table A.1**: Description of the samples used for the simulations, data as of end 2009[13].*

	Number G1 Banks	Number G2 Banks	Sample % Population[14]	Total Assets (m€)	Total Liabilities (m€)	Total Interbank Debt[15] (m€)	Total Interbank Credit[16] (m€)	Total Covered Deposits(+) (m€)	Total Capital Requirements (8% RWA) (m€)	Total Capital (m€)	DGS/RF funds[17] (+) (m€)
BE	3	20	82.26%	878.336	829.934	184.888	160.678	260.890	23.413	48.401	2.516
BG(*)	0	24	185.35%	67.247	57.919	12.754	12.754	27.526	4.379	9.328	437
DK	3	96	71.05%	756.678	708.878	143.362	92.279	118.179	23.749	47.800	2.168
DE	6	1476	64.19%	4.648.331	4.415.620	1.086.016	790.975	1.093.841	125.452	232.711	20.096
GR	3	13	71.42%	322.714	295.667	43.441	20.313	135.758	16.781	27.047	1.511
ES	8	135	73.95%	2.370.807	2.188.636	348.780	226.113	542.332	115.565	182.171	7.874
FR	17	178	102.59%	7.191.608	6.817.107	842.666	779.727	1.550.504	245.024	374.500	22.850
IE(*)	5	19	101.91%	1.221.181	1.155.789	276.738	148.729	147.145	44.121	65.392	3.488
IT	8	465	81.81%	2.827.051	2.556.174	188.375	195.958	476.963	97.416	270.876	7.816

[13] Year 2009 is the latest year available in *Bankscope* and, even more importantly, 2009 is the year on which the Basel and the CEBS committee have based their Quantitative Impact Study exercises for the foreseen change on banks' capital and RWA when moving from Basel II to Basel III.

[14] The sample of banks covered in each Member States represents the indicated percentage of total assets for any Member State as shown for 2009 in the 2010 ECB EU banking structures publication, computed as the amount of total assets for all banks minus total assets of branches from abroad. European Central Bank (2010), *EU banking structures*, http://www.ecb.int/pub/pdf/other/eubankingstructures201009en.pdf

[15] A correction factor for the volume of the interbank debt/credit has been applied to the following MS, to correct for the inclusion of some classes of debts certificates: GR (56.5%), FR (39.1%), IT (26.9%), LU (79.8%), and AT (48.4%). The correction factors employed have been estimated using the 2010 ECB *Banking Sector Stability*, Table 11a.

[16] Data on interbank credits was not available for BG and CY so equality of interbank debits and credits has been assumed.

[17] The amount of funds for DGS/RF purposes is rescaled on the size of the sample (column 3 in Table A.1).

	Number G1 Banks	Number G2 Banks	Sample % Population[14]	Total Assets (m€)	Total Liabilities (m€)	Total Interbank Debt[15] (m€)	Total Interbank Credit[16] (m€)	Total Covered Deposits(+) (m€)	Total Capital Requirements (8% RWA) (m€)	Total Capital (m€)	DGS/RF funds[17] (+) (m€)
CY (*)	0	15	80.80%	107.446	100.436	53.067	53.067	22.661	4.883	7.011	537
LV(*)	0	21	72.65%	19.088	17.037	5.943	2.609	3.995	1.127	2.050	58
LU	1	55	68.35%	465.539	441.916	169.984	161.827	103.441	11.485	23.622	1.321
MT	0	10	43.83%	18.076	16.225	5.222	2.689	6.893	760	1.851	58
NL	4	17	78.02%	1.680.455	1.600.687	319.699	398.659	314.059	46.903	79.768	5.091
AT	1	172	29.88%	306.457	282.380	50.382	39.692	71.381	14.656	24.077	860
PT	3	11	66.49%	323.762	297.421	43.561	34.505	82.952	17.704	26.342	1.121
FI	1	8	78.36%	290.500	275.621	54.361	79.820	48.998	7.968	14.879	1.024
SE	3	63	52.37%	455.355	422.301	97.604	122.872	75.383	16.356	33.054	1.314
UK	7	78	73.97%	4.278.074	4.074.946	743.978	691.049	464.241	110.757	203.129	12.313

Notes: (*) Source is Central Bank or Supervisory Authority; (+) Estimated

ANNEX B: Calculation of individual banks' expected yearly losses

Let K be the total number of model simulations (including the ones without default), H the number of banks in the system and $L(i,j)$ the (excess) loss of the i-th bank in the simulation run j-th.

The systemic loss in the simulation run j-th is the sum of individual banks' excess losses:[18]

$$L_{Syst}(j) = \sum_{i=1}^{H} L(i, j) .$$

The contribution of bank i to systemic losses is defined as the expected yearly loss for this bank and is estimated as its average loss over the **whole** set of simulations, as it follows:

$$c(i) = \frac{\sum_{j=1}^{K} L(i, j)}{K}$$

The percentage contribution of each individual bank to the systemic risk is thus:

$$pc(i) = \frac{c(i)}{\sum_{h=1}^{H} c(h)} .$$

It is also possible to focus the attention on the tail of the loss distribution and determine the contribution of each bank in causing losses higher than a certain threshold T (i.e. the contribution of a bank in determining systemic losses **above** the threshold T):

$$c(i)\big|_{>T} = \frac{\sum_{j=1}^{K} \left[L(i, j) \big| L_{Syst}(j) > T \right]}{K}$$

$$pc(i)\big|_{>T} = \frac{c(i)\big|_{>T}}{\sum_{h=1}^{H} c(h)\big|_{>T}}$$

The contribution of a bank **below** the threshold T is obtained considering the difference between average yearly contributions on the whole set of simulations and on the runs with losses above the threshold:

$$c(i)\big|_{\leq T} = c(i) - c(i)\big|_{>T}$$

$$pc(i)\big|_{\leq T} = \frac{c(i)\big|_{\leq T}}{\sum_{h=1}^{H} c(h)\big|_{\leq T}} .$$

[18] Excess losses of non-defaulted banks are zero.

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Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

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ANNEX 15

EFFECTS ON MACROECONOMIC VARIABLES

A. ANALYSING THE EFFECTS OF A FINANCIAL ACTIVITY TAX AND A BANK LEVY

1. INTRODUCTION AND SUMMARY

The financial crisis of 2008/09 had major budgetary implications and increased levels of public debt in the EU from slightly below 60% of GDP to more than 80% of GDP. There is a debate on how to make the financial sector contribute to the budgetary cost of the bank rescue measures plus other fiscal stimulus packages. Also the question has been raised whether tax policies could be used to affect leverage of the banking sector. Possible benefits of financial sector taxation must be evaluated against potential costs resulting from higher capital costs for borrowers which can result if banks are shifting taxes onto lending rates.

This paper analysis the macroeconomic consequences of two financial sector tax instruments, namely a financial activity tax and a bank levy, using a DSGE model with a banking sector. For this purpose, we disaggregate the household sector into borrowers and lenders and introduce a corporate banking sector. The banking sector provides loans to entrepreneurs. Liabilities of banks consist of deposits and bank capital. The banking sector can be subject to various forms of taxation. As noted by Keen (2011), the public finance literature so far provides little guidance on financial sector taxation, the model presented in this paper tries to partially fill this gap.

We are interested in the following aspects:

- What are the macroeconomic effects of taxes on bank activities?
- What is the potential of these taxes to raise government revenue?
- Do taxes affect bank leverage?

2. THE MODEL

This section describes in more detail the decision problems faced by individual sectors of the economy. In order to allow for a meaningful financial intermediation function of banks we disaggregate the household sector into savers and borrowers (entrepreneurs). Saver

households allocate their savings across government bonds, deposits and bank equity. In order to allow for interbank lending and borrowing we split up the banking sector into "savings" and "investment" banks. Savings banks collect deposits from households, and only lend to investment banks in the interbank market. Investment bank can borrow from households in the form of deposits or from savings banks. Investment banks provide loans to entrepreneurs.

2.1. Entrepreneurs

There is a continuum of entrepreneurs distributed over a unit interval $i \in (0,1)$. Entrepreneur *i* uses a CRS technology to produce goods (*Y*) which are imperfect substitutes for goods produced by its competitors and we assume monopolistic competition. In addition we assume that price changes are subject to adjustment costs. Entrepreneurs maximise an intertemporal utility function over distributed profits (C^E) which they use for consumption. At the beginning of each period, the entrepreneur makes investment (*I*) and labour demand (*N*) decisions. Firms partly finance investment by taking out loans (*L*) from the banking sector. To prevent over borrowing, banks impose a collateral constraint by restricting loan supply to fraction ξ of the value of the capital stock. It is assumed that entrepreneurs have a higher discount rate compared to savers. This ensures that entrepreneurs have a positive stock of outstanding loans in the steady state. The optimisation problem of entrepreneurs can be written as follows

(1)

$$Max\, V_0^E = \sum \beta^{Et} \log C_{it}^E +$$

$$\sum \lambda_{it}^E \beta^{E,t} \left[L_{it} - (1 + r_{t-1}^L) L_{it-1} - C_{it}^E - q_t^K I_{it} + (\frac{P(Y_{it})}{P_t} Y_{it} - W_t N_{it}) - \gamma_p (\frac{P(Y_{it})}{P(Y_{it-1})} - \bar{\pi})^2 \right] -$$

$$- \sum \lambda_{it}^E \theta_t^E \beta^{Et} \left[Y_t\ (K_{it}, N_{it}) - Y_{it} \right]$$

$$- \sum \lambda_{it}^E \phi_{it}^K \beta^{E,t} \left[K_{it} - I_{it} - (1-\delta) K_{it-1} \right]$$

$$- \sum \lambda_{it}^E \psi_{it}^E \beta^{E,t} \left[(1 + r_t^L) L_{it} - \xi (1-\delta) q_t^K K_{it} \right]$$

First order conditions

(2a) $$\frac{\partial V_{it}^E}{\partial C_{it}^E} = \frac{1}{C_{it}^E} - \lambda_t^E = 0$$

(2b) $$\frac{\partial V_{it}^E}{\partial L_{it}} = \lambda_{it}^E (1 - \psi_{it}^E (1 + r_t^L)) - \lambda_{it+1}^E \beta^E (1 + r_t^L) = 0$$

(2c) $$\frac{\partial V_{it}^E}{\partial K_{it}} = -\lambda_{it}^E \phi_{it}^K + \lambda_{it}^E \psi_{it}^E \xi (1-\delta) q_{it}^K + \lambda_{it+1}^E \phi_{it+1}^K \beta^E (1-\delta) + \lambda_{it}^E \theta_{it} Y_{K,it} = 0$$

(2d) $$\frac{\partial V_{it}^E}{\partial I_{it}} = -\phi_{it}^K + q_{it}^K = 0$$

(2d) $$\frac{\partial V_{it}^E}{\partial Y_{it}^E} = -\lambda_{it}^E (1 + \varepsilon (1 + \gamma_p (\beta^E{}_t \pi_{it+1} - \pi_t))) \frac{P_{it}}{P_t} + \lambda_{it}^E \theta_{it} = 0 \quad , \quad \varepsilon = \frac{\partial Y_{it}^d}{\partial P_{it}} \frac{P_{it}}{Y_{it}^d} < 0$$

How the collateral constraint affects consumption (distributed profits) and investment can be illustrated by looking at the consumption and investment rules

Consumption of entrepreneurs

(2b') $$\frac{C_{it+1}^E}{C_{it}^E} = \frac{(1 + r_t^L)\beta^E}{(1 - \psi_{it}^E (1 + r_t^L))}$$ ψ_{it}^E**:** Lagrange Multiplier of Collateral constraint

Investment

(2c') $$Y_{K,it} = r_t^L + \delta + \psi_{it}^E (1 - \xi)$$

The Lagrange multiplier of the collateral constraint ψ_t^E acts like a risk premium to the interest rate of entrepreneurs. A tightening of the constraint thus lowers consumption and investment. The effect on consumption and investment is, however, not symmetric. Collateral tightening reduces consumption more strongly than investment. This asymmetric response is optimal for the entrepreneur, who takes into account that reducing investment would further tighten the borrowing constraint.

2.2. Capital producers

Capital producers transform a fraction of final goods into investment goods. They are perfectly competitive and maximise profits, using a technology which is subject to convex adjustment costs. They use the discount factor β^K

$$(3) \qquad \text{Max } E_t \sum \beta^{K\,t} \left\{ q_t^K I_t - \left(I_t + \frac{\gamma_K}{2}\left(\frac{I_t^2}{K}\right) + \frac{\gamma_I}{2}\left(\frac{I_t}{I_{t-1}} - 1\right)^2 I_t \right)_t \right\}$$

The first order condition of this maximisation problem yields a price for the capital good which is equal to

$$(3a) \qquad q_t^K = 1 + \gamma_K\left(\frac{I_t}{K}\right)\frac{1}{K} + \gamma_I\left(\frac{I_t}{I_{t-1}} - 1\right)\frac{I_t}{I_{t-1}} - \gamma_I \beta^K \left(\frac{I_{t+1}}{I_t} - 1\right)\left(\frac{I_{t+1}}{I_t}\right)^2$$

2.3. Savers

Saver households have a standard utility function over consumption (C_t^S), deposits (*D*) and leisure (*1-N*). Households make portfolio decisions about government bonds *B*, bank deposits *D* and bank equity *E*, i. e. by holding shares in banks which pay a dividend div_t in period t and have a price q_t^E. Savers pay a lump sum tax *T*.

(4) $$Max \quad V_0^S = \sum_{t=0}^{\infty} \beta^{St} \left(\log(C_t^S) + \frac{\omega_D}{1-1/\kappa_D} D_t^{1-1/\kappa_D}) + \frac{\omega_N}{1-1/\kappa_L} (1-N_t)^{1-1/\kappa_L} \right) -$$
$$\sum_{t=0}^{\infty} \lambda_t^S \beta^{St} \left[\begin{array}{l} \Delta D_t + \Delta B_t + q_t^{IB} \Delta E_t^{IB} + q_t^{SB} \Delta E_t^{SB} - \\ r_{t-1}^D D_{t-1} - r_{t-1}^B B_{t-1} + C_t - div_{t-1}^B E_{t-1}^B + risk_{t-1}(E_{t-1}^B) - W_t N_t - T_t \end{array} \right]$$

Financial wealth: $$FW_t = D_t + B_t + q_t^B E_t^B$$

First order conditions

(4a) $$\frac{\partial V_t^S}{\partial C_t^j} => \frac{1}{C_t^S} = \lambda_t^S$$

(4b) $$\frac{\partial V_t^S}{\partial D_t} = \omega_D D_t^{-1/\kappa D} - \lambda_t^S + \lambda_{t+1}^S \beta^S (1 + r_t^D) = 0$$

(4c) $$\frac{\partial V_t^S}{\partial B_t} = -\lambda_t^S + \lambda_{t+1}^S \beta^S (1 + r_t^B) = 0$$

(4d) $$\frac{\partial V_t^S}{\partial E_t^{IB}} = -\lambda_t^S q_t^B + \lambda_{t+1}^S \beta^S (q_{t+1}^B + div_t^B - risk_t^E) = 0$$

(4e) $$\frac{\partial V_t^S}{\partial N_t^{SB}} = \omega_N (1-N)^{-1/\kappa_L} + \lambda_t^S W_t = 0$$

The following arbitrage condition holds between the return on bank equity r_t^E and the riskless rate

(5) $$(1+r_t^E)=\frac{q_{t+1}^E}{q_t^E}+\frac{div_t^E}{q_t^E}=(1+r_t^B+risk_t^E)$$

Consumption

(4c') $$\frac{C_{it+1}^S}{C_{it}^S}=(1+r_t^B)\beta^S$$

Demand for Deposits

(4b') $$D_t=\left(\frac{\omega_D C_t^S}{r_t^B-r_t^D}\right)^{\kappa D}$$

Labour supply

(4d') $$N_t=1-\left(\frac{\omega_N C_t^S}{W_t}\right)^{\kappa N}$$

2.4. Banks

The banking system transforms savings of households into loans for entrepreneurs. We assume that there is a continuum of monopolistically competitive banks indexed by j. They face a demand function for loans

(5) $$L_{jt}=s_j\left(\frac{r_t^L}{r_{jt}^L}\right)^{\varepsilon^L}L_t$$

At the beginning of period t, banks make decisions about loans L_t, deposits D_t liquid assets B_t and loan interest rates r_t^L, taking r_t^D and r_t^B as given. Banks face capital requirement and liquidity requirement constraints.

We consider a simple balance sheet, where total assets consist of loans and liquid assets (B) . Total liabilities are the sum of deposits (D) and bank equity (V^B). The banking sector faces a capital requirement and a liquidity requirement constraint. The capital requirement is formulated in terms of risk weighted assets

(6) $$V^B = \Gamma(\omega_L L + \omega_B B)$$

In addition there is a liquidity requirement, which restricts banks to hold liquid assets as a fraction Γ^B of loans

(7) $$B = \Gamma^B L$$

We assume that banks buy (labour) services from the household sector and use the following simple technology to manage their activities. Total employment in the banking sector N_t^B is divided into overhead labour $N_t^{B,F}$ and labour used for intermediation services $N_t^{B,V}$ which is proportional to loans

$$N_t^{B,V} = \theta L_t$$

Let w_t^B be the wage rate in the banking sector, then total and marginal wage cost are given by

$$C_t^B = w_t^B (N_t^{B,F} + N_t^{B,V}) = w_t^B N_t^B$$

$$MC_t^B = w_t^B \theta$$

The cash flow of the bank in each period is given by equation 8.

(8)

$$div_{jt-1}E^{B}_{jt-1} = (1-t^{A})(r^{L}_{t-1}(L_{t-1})L_{jt-1} + r^{B}_{t-1}B_{jt-1} - r^{D}_{t-1}D_{jt-1}) - t^{L}D_{j,t-1} - w^{B}_{t}(N^{B,F}_{t} + \theta L_{t}) + \Delta D_{jt} - \Delta B_{jt} + q^{B}_{jt}\Delta E^{B}_{jt} - \Delta L_{jt}$$

Each period the investment bank pays out dividends to its shareholders. Dividend payments are constrained by the cash flow of the bank. The cash flow consists of revenues from loan interest payments of entrepreneurs ($r^{L}_{jt-1}L_{jt-1}$) and interest receipts from holding liquid assets ($r^{B}_{t-1}B_{t-1}$) minus interest payments on deposits ($r^{D}_{t-1}D_{t-1}$) and minus wage costs ($W^{B}_{t}N^{B}_{t}$). Interest receipts and expenditures are based on loan and financing decisions of the previous periods. The current period cash flow can be increased by increasing deposits and bank capital and is reduced by increasing loans or liquid assets. The variables (t^{A}, t^{L}) are financial activity tax rates and a bank levy. The financial activity tax, taxes current bank profits, however wage costs are not deductable. The bank levy taxes the stock of bank debt[1].

Let us define the stock market value of the investment bank as

(9) $$V^{B}_{t} = q^{E}_{t}E_{t-1}$$

And take into account the discount rate (r^{E}_{t}) the household applies to bank equity, the stock market value of the bank is given by

(10) $$V^{B}_{t-1}(1+r^{E}_{t}) = DIV^{B}_{t-1} + {}_{t-1}V^{B}_{t} \quad \text{where } DIV^{B}_{t-1} = div^{B}_{t-1}E^{B}_{t-1}$$

Solving forward (10) gives the stock market value of the bank as the PDV of dividends

[1] Notice, the model does not make a distinction between deposits and other liabilities. The bank levy is regarded as a tax on other rliabilities only, the bank levy rate must be scaled appropriately.

(11) $V_t^B = \sum_{f=0}^{\infty} \prod_{k=0}^{t} (1 + r_{t+k}^E)^{-k} DIV_{t+f}$

The bank maximises (11) w. r. t. L, B and D, subject to (6), (7) and (8). One technical problem arises because the value to be maximised (V^B) appears itself in a constraint. This problem can be handled by using dynamic programming

$$V^B(L_{t-1}, B_{t-1}, D_{t-1}) = Max\left\{ DIV_t + E_t \frac{1}{1 + r_t^E} V^B(L_t, B_t, D_t) \right\}$$

(12) $-\lambda_t [8]$
$-\mu_t [6]$
$-\psi_t [7]$

Then we can write the first order conditions of the bank's maximisation problem as follows

(13a) $$\frac{\partial V_t^B}{\partial DIV_t} = 1 - \lambda_t = 0$$

(13b) $$\frac{\partial V_t^B}{\partial L_t} = -\lambda_t + \frac{(1 - \mu_t (1 + (r_t^L (1 - \varepsilon^L)(1 - t^A) - w_t^B \theta))}{(1 + r_t^E)} + \mu_t \Gamma \omega_L + \psi_t \Gamma^B = 0$$

(13c) $$\frac{\partial V_t^B}{\partial B_t} = -\lambda_t + \frac{(1 - \mu_t)(1 + (1 - t^A) r_t^B)}{(1 + r_{t+1}^E)} + \mu_t \Gamma \omega_B - \psi_t = 0$$

(13d) $$\frac{\partial V_t^B}{\partial D_t} = \lambda_t + \frac{(1-\mu_t)(1+(1-t^A)r_t^D + t^L)}{(1+r_{t+1}^E)} = 0$$

Rearranging the FOC's yields

(14a) $$(1-t^A)r_t^L(1-\varepsilon^L) = w_t^B\theta + \left\{\Gamma\omega_L r_t^E + (1-\Gamma\omega_L)((1-t^A)r_t^D + t^L)\right\} + \left[\Gamma\omega_B r_t^E + (1-\Gamma\omega_B)((1-t^A)r_t^D + t^L) - (1-t^A)r_t^B\right]\Gamma^B$$

Or

(14b) $$r_t^L(1-\varepsilon^L) = \frac{w_t^B\theta}{(1-t^A)} + \left\{\frac{\Gamma\omega_L r_t^E}{(1-t^A)} + (1-\Gamma\omega_L)(r_t^D + \frac{t^L}{(1-t^A)})\right\} + \left[\frac{\Gamma\omega_B r_t^E}{(1-t^A)} + (1-\Gamma\omega_B)(r_t^D + \frac{t^L}{(1-t^A)} - r_t^B)\right]\Gamma^B$$

Equation (14b) shows the loan interest rule that can be derived from the bank's optimisation problem. The loan interest rate is determined as a mark up over marginal cost (the mark up factor is given by $1/(1-\varepsilon^L)$. The marginal cost items have a quite intuitive interpretation and show in particular how the regulatory constraints and taxes affect marginal cost.

The first term on the RHS (in curly brackets) is the weighted average of the return on equity and the deposit rate and the weights are the share of equity and deposits in total assets. An increase in capital requirements (Γ), increases marginal costs for banks, since they have to finance a larger share of loans with more expensive bank equity.

The second term (term in square brackets) can be interpreted as the opportunity cost for the bank arising from holding liquid assets. The term in square bracket is the difference between

the costs of raising funds for financing liquid assets and the return from liquid assets. This term is multiplied with the required liquidity ratio Γ^B . This constitutes the marginal cost to the bank of increasing loan supply (notice is a cost to the bank only if the term in square brackets is positive).

Equation (14b) also shows how individual taxes affect the loan supply/loan interest rate decision of the bank. First, it can be seen that a financial activity tax is effectively a tax on bank equity and bank employment. This tax is shifted onto the loan interest rate. The size of the tax shift depends on the (risk adjusted) ratio between bank equity and loans ($\Gamma\omega_L$) and marginal employment cost ($w^B\theta$). Similarly a bank levy on bank debt is also shifted onto the loan interest rate.

2.5. Government

The government budget constraint is standard. Government spending (G) is financed by (lump sum) taxes (T) from the non financial sector, a bank levy, a financial activity tax[2] and government bonds which can either be sold to households (B) or to the central bank (B_t^{CB}). Other financial market policies such as taxing financial transactions and bank profits could in principle be modelled by adjusting the government budget constraint and modifying the budget constraints of banks, households and firms

(18) $$B_t + B_t^{CB} = (1 + r_{t-1}^B)(B_{t-1} + B_{t-1}^{CB}) + G_t - T_t - T_t^B - profit_t^{CB}$$

T^B denotes the sum of financial activity tax and bank, levy and is given by

$$T_t^B = t^A(r_{t-1}^L L_{t-1} + r_{t-1}^B B_{t-1}^B - r_{t-1}^D D_{t-1}) + t^L D_{t-1}.$$

2.6. Central Bank

The central bank generates profits from providing household with cash (*M*) and earns interest from purchasing government bonds (B_t^{CB}) (currently B_t^{CB} is set to zero).

[2] Both the financial activity tax and the bank levy is zero at the baseline.

(19) $$\frac{\Delta M_t}{P_t} - B_t^{CB} = -(1 + r_{t-1}^B) B_{t-1}^{CB} + profit_t^{CB}$$

Policy rule I: (price level targeting)

(20) $$P_t = \overline{P}$$

Policy Rule II: (Taylor rule, inflation targeting)

The CB can influence the nominal interest rate (of government bonds) via changing the supply of money. Since money demand is a function of the nominal interest rate on government bonds, a money supply rule can be formulated where the CB responds with the supply of money in order to stabilise some targets (e. g. inflation or nominal interest rate);

A general rule would be

(21a) $$t_M (M_t - M_t^T) = -t_\pi (\pi_t - \pi_t^T) + t_{inom} (inom_t - inom_t^T)$$

Where $inom_t = rb_t + \pi_{t+1}$

A special case would be a Taylor rule

(21b) $$\Delta inom_t = t_\pi (\pi_t - \pi_t^T)$$

An equilibrium in this economy is given by a set of optimality conditions for savers, entrepreneurs, investment and savings banks concerning consumption, investment, labour supply and demand as well as asset allocation. The set of relative prices and rates of return ($w_t, q_t^E, r_t^L, r_t^D, r_t^{DIB}$) clear markets labour, bank equity, loans, deposits and interbank loans and establish an equilibrium between investment and savings.

3. CALIBRATION

All parameters describing behaviour of the non financial sector are taken from Ratto et al. (2009). As a baseline for the financial sector tax we assume that the capital requirement directive (CRDIV) is implemented starting in 2012 with the banking sector adjusting to new capital and liquidity requirements (with a transition period lasting until 2019), the implementation of a deposit guarantee scheme (reaching 2% of eligible deposits) and the build-up of a countercyclical buffer. We use information from the EU Quantitative Impact Study (QIS), which suggests that the ratio of tier 1 capital to risk weighted assets at the end of 2009 was around 6%. The risk weight for the two types of assets is 55% for loans and 5% for government bonds respectively. Also based on the EU QIS report we assume that the ratio of liquid to non liquid assets in the balance sheet of the banking sector is 8.5% at the end of 2009. Our preferred balance sheet concept for the banking sector is a consolidated balance sheet, which provides information about the stock of loans to the non financial sector. This gives us the leverage position of the non financial private sector, and yields an accurate estimate of the (loan) capital cost of the private sector. This is important for calculating the macroeconomic impact of the regulatory measure[3].

Concerning aggregate lending of banks to the non financial private sector the model must replicate a loan to GDP ratio of about 1.3. The interest data are from the ECB and other EU27 central banks. The pre-crisis figures suggest a loan interest rate of 5.2%, a deposit rate of 2.5% and a rate on government bonds of 4.2%. The rate of return on bank equity was at a historical low because of the financial crisis. We therefore use an average value from previous years (14.3%). Based on data from Eurostat, V. Escudero (2009) reports that the employment share of financial intermediaries in total employment is about 3% in EU27.

The interest semi-elasticity of the supply of deposits of households (ISED) is a crucial parameter for this exercise, since it determines by how much deposit rates will fall if the demand for deposits by banks declines. Unfortunately ISED is not very precisely estimated and is likely to be time varying with standard CRRA specifications of the utility function. For the US, the semi elasticity estimates vary between 5 and 10 (see Ball (2001)), For the EA estimates of ISED range between 1 and 3 (see, for example, Beyer (2009), Bruggemann et al. (2003) and Dedola (2001)). Especially Dedola et al. point out that data and aggregation problems in Euro area countries may significantly bias downwards the interest elasticity estimates in the Euro area. In a recent paper Inagaki (2009) estimates a time varying semi elasticity for the US and Japan and notes that the semi elasticity can be high in low inflation environments. For the US his ISED estimate ranges between 4 and 36 (with a peak reached in 2003) while in the case of Japan the estimate ranges between 2.5 and 874 (in 2005). As a benchmark we use ISED=10, but we provide results for higher vales as well.

[3] Because we only have an unconsolidated balance sheet of the banking sector for EU27 we make the assumption that the ratio of loans to the non financial sector and interbank loans is identical in the EU27 and the EA. And we know from the consolidated EA balance sheet that loans to the non financial sector are about 130% of GDP.

4. SIMULATION RESULTS

We are interested in the following questions:

- What are the macroeconomic effects of axes on bank activities?
- What is the potential of these taxes to raise revenue for the government?
- Do taxes have an impact on bank leverage?

We look at two types of taxes, a financial activity tax which is a tax on bank profits (without deductibility of wage costs) and a bank levy which is a tax on bank debt.

Financial Activity Tax (FAT)

Table (1): The effect of a 5% FAT (anticipated to be introduced in 2015). Share of fixed employment: 0.5

	2012A	2013A	2014A	2015A	2020A	2050A	2150A
Y	-0.05	-0.06	-0.09	-0.12	-0.21	-0.44	-0.50
I	-0.81	-1.31	-1.49	-1.58	-1.47	-1.21	-1.19
C	0.13	0.24	0.25	0.22	0.06	-0.36	-0.47
K	-0.02	-0.06	-0.11	-0.17	-0.42	-1.01	-1.18
LO	-0.13	-0.35	-0.46	-0.49	-0.67	-1.09	-1.21
D	0.59	0.45	0.40	0.40	0.28	-0.03	-0.01
VB	-0.15	-0.36	-0.44	-0.50	-0.68	-1.09	-1.22
RD	-4.05	-2.89	11.39	-2.32	-2.30	-0.76	-0.16
RE	-5.90	-4.29	10.19	-3.41	-3.16	-0.73	-0.26
RLO	-10.13	-7.22	15.41	10.58	12.54	13.86	14.70
SPREAD	-6.08	-4.33	4.02	12.90	14.84	14.63	14.85
CCSHADOW	20.44	3.54	-2.25	3.19	3.43	5.39	6.04

L	-0.07	-0.06	-0.07	-0.08	-0.07	-0.05	-0.05
TLEVY	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TFATY	0.00	0.00	0.00	0.18	0.22	0.21	0.21

Note: Y: GDP, I: Investment, K: Capital stock, C: Consumption, LO: Stock of loans, D: Stock of debt/depoits, VB: stock market value of the bank, RD: Deposit rate, RE: rate of return on bank equity, RLO: Loan rate, SPREAD: difference between loan and deposit rate, ZETA: Lagrange multiplier of collateral constraint ,CCSHADOW: Capital cost including Lagrange Multiplier of credit constraint, L: employment, TLEVY: Bank levy as a share of GDP, TFATY: Financial activity tax as a share of GDP. Y, C, I, K, LO, D, VB, N are % deviations from baseline. RD, RE, RLO, SPREAD, CCSHADOW: are in BP. TLEVY, TFATY: are % point deviations.

A financial activity tax is shifted onto loan interest rates. This increases capital costs for firms and lowers investment and the capital stock[4] and reduces GDP. The loss in GDP is predominantly generated by a reduction of investment. The negative effects of the FAT on employment are minor. With standard wage setting rules wages are determined by productivity in the long run. I. e. real wages decline and stabilise employment. One important policy issue concerns the impact of a FAT on bank leverage, in particular on the ratio of bank equity to debt. Given the capital requirement which links bank equity to loans, the ratio between loans and bank equity is not affected by taxation. However this does not rule out that the ratio between bank equity and bank debt (deposits) changes. As can be seen from the table above, banks find it optimal to increase debt relative to bank equity. The economic intuition in the context of this model is as follows: Given the optimal loan interest rate rule, a unit increase of t^A lowers after tax revenues from lending per unit of loan by $r^D(1-\Gamma)/(1-\varepsilon^L)$ and lowers cost roughly by $r^D(1-\Gamma)$. The loss in revenue exceeds the cost reduction by the factror $1/(1-\varepsilon^L)$, because the FAT also taxes monopoly rents. In order to increase dividend payments it is optimal for the bank to increase indebtedness. Notice however, there are limits to this because an increase in the demand for deposits raises interest rates on deposits (which leads to second round effects on loan rates). Also the capital requirement constraint imposes a limit on bank debt. The FAT introduced with a rate of 5% would generate additional government revenues of 0.2% of GDP. [5]

A Levy on bank debt:

[4] Notice, the tax are given back to households in the form of an increase in lump sum transfers. The GDP losses would be smaller in the case of a budgetary neutral reduction of distortionary taxes. Lump sum transfer compensation was chosen here in order to show the effects of the FAT without mixing them up with the effects of a distortionary tax.

[5] Note that if the baseline would be Basel II, the results would barely change. Actually, the FAT base is slightly larger under Basel III. In the long-term, under Basel II, a 5% FAT would collect 0.19% GDP (comp. 0.20% under Basel III) and lead to -0.45% GDP (comp. -0.54% under Basel III).

Table (2): The effect of a bank levy of 0.05% on other liabilities (anticipated to be introduced in 2015)

	2012A	2013A	2014A	2015A	2020A	2050A	2150A
Y	-0.00	-0.00	-0.01	-0.01	-0.02	-0.03	-0.03
I	-0.04	-0.08	-0.11	-0.13	-0.12	-0.10	-0.08
C	0.01	0.02	0.02	0.02	0.01	-0.03	-0.03
K	-0.00	-0.00	-0.01	-0.01	-0.03	-0.08	-0.08
LO	-0.00	-0.02	-0.03	-0.04	-0.05	-0.09	-0.08
D	-0.38	-0.39	-0.39	-0.39	-0.41	-0.44	-0.48
VB	-0.00	-0.01	-0.02	-0.04	-0.05	-0.09	-0.08
RD	-0.23	-0.18	0.30	-2.25	-1.79	-1.73	-1.82
RE	1.20	1.30	1.84	-0.83	-0.17	0.00	0.04
RLO	-0.67	-0.56	0.30	0.45	1.01	1.08	0.96
SPREAD	-0.44	-0.38	-0.00	2.70	2.80	2.82	2.78
CCSHADOW	0.12	-0.46	-0.85	0.58	0.22	0.41	0.39
L	-0.00	-0.00	-0.01	-0.01	-0.01	-0.00	-0.00
TLEVY	0.00	0.00	0.00	0.07	0.07	0.07	0.07
TFATY	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Like in the case of a FAT, a levy on bank debt is also shifted onto loan interest rates and reduces capital formation and GDP. In contrast to the FAT, a bank levy reduces debt relative to bank equity, since banks shift away from debt financing in order to reduce increased costs of debt. By reducing the demand for debt banks can shift the burden of the levy onto depositors. This policy measure would generate additional revenues as a share of GDP of about 0.07% in the medium to long run[6]. The magnitude of the GDP loss (if one controls for the revenues generated) seems smaller compared to the FAT. The next section will explore the sensitivity of the macroeconomic effects of both tax policies to underlying model assumptions.

[6] Other liabilities, which are tax base for the bank levy constitute about 170% of EU27 GDP.

Financial activity tax and bank levy:

Table (3) shows the combined effect, which is essentially the sum of the two effects.

Table (3): The combined effect of a 5% FAT and a 0.05% Bank levy on other liabilities (both anticipated to be introduced in 2015)

	2012A	2013A	2014A	2015A	2020A	2050A	2150A
Y	-0.05	-0.07	-0.09	-0.12	-0.22	-0.47	-0.53
I	-0.85	-1.39	-1.61	-1.71	-1.60	-1.30	-1.26
C	0.14	0.25	0.27	0.24	0.06	-0.39	-0.50
K	-0.02	-0.07	-0.12	-0.18	-0.45	-1.09	-1.26
LO	-0.14	-0.36	-0.49	-0.53	-0.72	-1.18	-1.30
D	0.18	0.04	-0.03	-0.02	-0.16	-0.50	-0.53
VB	-0.15	-0.37	-0.46	-0.54	-0.73	-1.18	-1.30
RD	-4.28	-3.07	11.68	-4.70	-4.20	-2.62	-2.11
RE	-4.64	-2.91	12.11	-4.29	-3.34	-0.72	-0.21
RLO	-10.82	-7.79	15.70	11.04	13.58	14.96	15.65
SPREAD	-6.54	-4.72	4.01	15.74	17.78	17.58	17.76
CCSHADOW	20.52	3.04	-3.16	3.80	3.67	5.81	6.43
L	-0.07	-0.07	-0.07	-0.09	-0.08	-0.05	-0.05
TLEVY	0.00	0.00	0.00	0.07	0.07	0.07	0.07
TFATY	0.00	0.00	0.00	0.18	0.22	0.21	0.21

The ratio of the GDP loss to revenues raised is 2.4 in the case of a financial activity tax but only 0.4 in the case of a bank levy, suggesting that the bank levy may be a more efficient revenue generating instrument. This section explains how this result emerges in the model and

provides additional sensitivity analysis concerning the robustness of this result. The reason for this result is that the burden of the two types of taxes is differently borne by depositors[7], equity owners and banks and this has implications for the lending rate. As shown in the previous section, the FAT is a tax on equity and variable bank employment while the bank levy is a tax on bank debt. Therefore the interest elasticity of the supply of deposits and the supply of equity matters as well as the extent in which bank employment is a variable factor of production. A crucial distinction between deposits and bank equity in the household portfolio is the liquidity service provided by deposits. This results in a finite (semi) interest elasticity of the supply of deposits in the short and the long run and we use estimated values for this elasticity. As is standard with infinitely lived households, the supply of funds is completely elastic in the long run and the rate on equity is determined entirely by the rate of time preference (and a constant equity premium). This elasticity difference between the supply of bank equity and the supply of deposits is crucial for the incidence of the two taxes. For FAT it is also important by how much the bank bears the tax on bank employment. This depends crucially on whether bank employment is a fixed or a variable factor of production. In the fixed factor case the bank shifts the tax onto bank equity holders, while in the case of variable labour the bank regards the FAT as a tax on marginal wage costs and is shifting it onto lending rates[8] and thus on investors. The following table provides results from a sensitivity analysis which looks at the impact supply elasticity for deposits and the nature of bank employment.

Table (4): Sensitivity Analysis (long run effects)

		GDP	Revenue	Spread	Loan rate	Deposit rate	GDP Loss over Revenue
A: Base Model	FAT	-0.50	0.21	14.9	14.7	-0.2	2.4
	Levy	-0.03	0.07	2.8	1.0	-1.8	0.4
B: High deposit elasticity	FAT	-0.47	0.20	13.4	13.5	0.1	2.6
	Levy	-0.14	0.08	3.8	3.8	0.0	1.8
C: High fixed	FAT	-0.28	0.18	1005	8.2	-1.8	1.5

[7] We use the term bank debt and deposits interchangeably. We speak of bank debt when we look at bank liabilities - other than bank capital - from the perspective of the bank and we use the term deposits when we look at bank liabilities (excluding bank capital) from the perspective of the household. In this model bank deposits serve two functions for households. First they provide a risk free rate of return and second, they provide liquidity services. The liquidity service function has implications for the long run interest elasticity of debt/deposit supply to the banking system and therefore for tax incidence.

[8] While we allow the bank technology to have an effect on how strongly the bank bears the FAT, the model does not allow for different degrees by which households supplying bank employment bear the tax. There is no bank specific wage because the supply of labour is assumed to be perfectly elastic across the non financial and the financial sector. However indirectly the bank technology affects how (banker households=equity holders) bear the FAT.

labour share	Levy	-0.16	0.08	5.4	4.8	-0.6	2.0

The ROE is not shown in the table since it is unaffected by the tax in the long run.

Elasticity of the supply of deposits:

A crucial difference between a FAT and a bank levy is its impact on the rate in which households are willing to supply funds to banks which we call the deposit rate. Since a FAT reduces the demand for debt while the bank levy reduces debt, the interest elasticity of deposit supply is important for determining how the two taxes affect bank funding costs. With a finite supply elasticity, FAT reduces the deposit rate by less compared to a bank levy. As explained in section 2, we have chosen a high semi elasticity given available estimates, nevertheless, this elasticity could be still too low since we apply it to total bank debt (and not all of it will provide liquidity services[9]). In order to highlight the importance of the elasticity difference between bank equity and bank debt (both provided by saver households) line **B** shows results with a deposit supply elasticity close to infinity. As can be seen, with a high elasticity, the deposit rate remains practically constant and consequently the relative efficiency of both taxes in terms of raising tax revenue becomes much closer. This shows that the efficiency difference between these two taxes is practically entirely explained by the fact that a bank levy under the standard model specification is applied to debt with a finite supply elasticity. If a bank levy is applied to bank debt other than deposits then specification **B** appears to be the more relevant case.

Fixity of Bank employment:

The degree in which bank employment is fixed or variable is crucial for who is bearing the financial activity tax. If employment is fixed banks shift the FAT more strongly to shareholders in the form of lower dividends and only pass on the equity component of the FAT to borrowers. This can be seen from line **C**. With a high share of fixed labour the efficiency of the FAT increases since the tax affects the lending rate and thus capital costs less. The fixity of bank employment also appears to affect the efficiency of the bank levy. This is, however, entirely due to the calibration. With a high fixed labour share a higher mark up in the banking sector must be assumed in order to match the loan rate to marginal funding costs (which are lower with fixed labour). This implies that changes in marginal cost have a larger impact on lending rates. Nevertheless this case is interesting since it shows that there are constellations of overhead labour shares and mark up size for which the efficiency of a FAT is larger than that of a bank levy.

[9] About 55% of bank liabilities (excl. Bank capital) are deposits and 45% are other liabilities.

A corporate income tax for banks (CIT)

Table (5): Effects of a corporate income tax on banks

	2012A	2013A	2014A	2015A	2020A	2050A	2150A
Y	-0.11	-0.13	-0.17	-0.23	-0.41	-0.87	-0.98
I	-1.67	-2.61	-2.89	-3.00	-2.86	-2.40	-2.30
C	0.26	0.48	0.49	0.43	0.11	-0.73	-0.92
K	-0.04	-0.13	-0.23	-0.34	-0.81	-2.02	-2.30
LO	-0.29	-0.74	-0.95	-0.96	-1.31	-2.16	-2.36
D	2.25	2.00	1.93	1.98	1.75	1.18	1.04
VB	-0.35	-0.79	-0.91	-0.98	-1.32	-2.17	-2.36
RD	-14.49	-10.05	23.46	0.10	1.34	3.74	4.30
RE	-22.21	-17.04	16.71	-6.77	-4.92	-0.94	-0.00
RLO	-20.49	-14.09	34.62	22.19	23.98	27.44	28.25
SPREAD	-6.00	-4.04	11.16	22.09	22.65	23.70	23.94
CCSHADOW	48.40	10.82	-2.29	6.30	6.01	10.51	11.57
L	-0.16	-0.13	-0.13	-0.15	-0.13	-0.10	-0.09
TLEVY	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TFATY	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TCITY	0.00	0.00	0.00	0.19	0.22	0.21	0.21

Table (5) shows the effects of an increase in CIT, generating similar revenue as a FAT. The essential difference between the CIT and a FAT is the tax deductability of bank wages. A comparison with the FAT shows that the CIT is more distortionary, i. e. associated with larger GDP losses. This is due to the fact banks only pass on a fraction of the tax deduction for bank wages onto loan interest rates, related to variable employment. Tax deductions for overhead labour increase bank profits.

5. CUMULATIVE EFFECT WITH REGULATORY MEASURES.

It is also interesting to report on the cumulative impact of regulatory measures and the application of a FAT, alone or on top of a bank levy. In the analysis here above, the calibration of the minimum capital requirements (the minimum quantity of capital) as well as the regulatory changes that aim at increasing the quality of bank capital (including the capital conservation buffer of 2.5%), the requirement to hold liquid assets agreed under Basel III and the introduction of harmonized deposit guarantee schemes (DGS) rules and the SIFI surcharge of 2% are considered as part of the baseline scenario[10].

It is however interesting to address the issue of the cumulative impact of the FAT with the regulatory measures (and possibly a bank levy). In the following simulations, a FAT is added to regulatory changes and to regulatory changes and a bank levy. The simulations offer a comparison with a baseline scenario of no regulatory changes (i.e. a Basel II framework).

Modelling the effects of stricter capital requirements necessitate assumptions on the effects holding an increased share of equity in the total funding sources on the cost of capital. Bank equity has indeed generally higher return than wholesale debt because they bear higher risk. This could in essence increase the weighted average cost of capital (WACC) for the financial institutions[11]. This statement has however been challenged by some studies (Admati et al., 2010; Miles et al., 2011). Indeed, at the other extreme, one can assume that the Modigliani-Miller (1958) theorem holds in full. In this case, an increase in capital requirements only redistributes the risks borne by equity owners. In other words, higher capital requirements improve the abilities of banks to withstand systemic pressure and reduce the risk premium on equity, therefore offsetting the increase in cost of capital due to a higher proportional use of equity.

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[10] The results presented here are necessarily limited to a number of regulatory reforms for the following reasons. On one hand, many of the planned regulatory reforms have not been finalised and adopted yet, which greatly reduces the possibility to quantify them at this stage. Such reforms include the taxation of financial activities, the introduction of a crisis management framework, the introduction of a "Single Rule Book", etc. On the other hand, the macroeconomic models that include a stylized financial sector limit the possibility of quantifying all the envisaged or adopted financial reforms. For example, the macroeconomic modelling of the reforms undertaken in the derivatives sector or targeting Central Counterparties (CCPs) still represents a challenge. Note that the effects of the DGS are probably overestimated as it is assumed to be financed by 2% of eligible deposits, which is high.

[11] In a stylized representation and in the absence of taxation, the WACC equals $\frac{E}{D+E} r_E + \frac{D}{D+E} r_D$, with E: equity, D: debt, r_E: return on equity and r_D: return on wholesale debt.

In line with Miles et al. (2011), the simulations here refer to a baseline scenario where the direct impact of the capital requirement on the cost of capital is 50%. This is the middle-case scenario in terms of economic effects. We will then refer to additional scenarios under which all of the cost are transferred and under which the cost of capital remains unchanged (in line with Modigliani-Miller, 1958). The three scenarios (No MM, 50% MM and 100%MM) lead to economic impacts of the regulatory measures as indicated in tables (6) and (7). It is shown that the assumptions about the direct pass-through of the capital requirement into the weighted-average cost of capital are keys to the results. In the worst-case assumption, an increase in the cost of capital by 14 basis points (0.14 percent) leads to a long-run GDP impact of -1.02% while in the optimistic assumption, the increase in the cost of capital is 2.9 basis point (0.029 percent) and leads to a long-run impact on GDP of -0.11%. It is very important to stress here that the simulation only considers the costs of stricter regulation and does not look at the benefits in terms of the decrease in the likelihood and consequences on the economy of banking crises.

Table (6). Cumulative impact of regulatory reforms: new quantitative and qualitative capital requirement, capital conservation buffer, the countercyclical capital buffer, SIFI surcharge, liquidity requirements, DGS harmonization vy (no loan-bond substitution - 50% MM offset).

	2012	2013	2014	2015	2016	2017	2018	2019	average 2020-2030	long term
Impact on macro variables (deviation from baseline in %)										
GDP	-0.14%	-0.14%	-0.17%	-0.24%	-0.28%	-0.32%	-0.35%	-0.37%	-0.47%	-0.72%
consumption	0.25%	0.48%	0.47%	0.41%	0.35%	0.27%	0.19%	0.10%	-0.19%	-0.66%
investment	-1.81%	-2.64%	-2.80%	-2.97%	-3.02%	-2.92%	-2.76%	-2.56%	-2.07%	-1.80%
labour hours	-0.20%	-0.14%	-0.13%	-0.17%	-0.18%	-0.16%	-0.15%	-0.14%	-0.10%	-0.07%
Impact on bank variables (deviation from baseline in %)										
volume of loans	-0.35%	-0.83%	-0.97%	-0.93%	-1.05%	-1.15%	-1.19%	-1.21%	-1.31%	-1.75%
volume of deposits	2.00%	1.69%	1.57%	3.47%	2.13%	1.77%	1.44%	1.10%	1.47%	2.04%
value of bank	-0.48%	-0.99%	-1.02%	-0.25%	64.09%	76.78%	89.52%	102.28%	73.62%	49.30%
Impact on bank variables (deviation from baseline in basis points)										
loan rate	-19.85	-12.26	43.89	24.83	21.93	26.74	28.23	26.97	21.76	20.56
deposit rate	-36.99	-33.65	33.92	21.13	-4.63	-4.91	-7.53	-12.08	0.41	12.65
return on bank equity	-43.66	-39.49	28.44	9.01	-12.03	-11.08	-12.54	-15.93	-5.06	4.75
firm cost of	64.34	23.14	-6.73	-1.62	8.20	7.51	8.52	10.48	7.18	6.64

Table (7). Sensitivity with regards to assumptions on the effect of capital regulations

2020-2030	0% MM	Baseline 50% MM	100% MM
Impact on macro variables (deviation from baseline in %)			
GDP	-1.02%	-0.47%	-0.11%
consumption	-0.22%	-0.19%	-0.16%
investment	-5.18%	-2.07%	-0.06%
labour hours	-0.24%	-0.10%	-0.01%
Impact on bank variables (deviation from baseline in %)			
volume of loans	-2.92%	-1.31%	-0.25%
volume of deposits	3.66%	1.47%	0.05%
value of bank	71.93%	73.62%	74.75%
Impact on bank variables (deviation from baseline in basis points)			
loan rate	47.61	21.76	5.29
deposit rate	5.51	0.41	-3.31
return on bank equity	-7.41	-5.06	-3.53
firm cost of capital	13.88	7.18	2.87

The 100% MM scenario assumes no direct change in the weighted-Average Cost of Capital from higher capital ratios. The baseline scenario assumes a 50% direct effect. The 0% MM scenario assumes full direct effects.

Next, it interesting to see from table (8) hereunder that regulatory changes effects and FAT effects are more or less cumulative. Revenues from FAT are unchanged compared to table (1) and the effects on the other variables are virtually the sum of the effects of regulatory changes and to FAT. In total, there is a cumulated long-term decrease in GDP of -0.83% compared to the baseline scenario. The cost of capital increases by 12.44 basis points and the spread increases by 42.74 basis points.

Table (8). The cumulative effect of a 5% FAT (anticipated to be introduced in 2015) with regulatory changes – 50% MM.

	2012	2013	2014	2015	2016	2017	2018	2019	average 2020-2030	long term
Impact on macro variables (deviation from baseline in %)										
GDP	-0.20	-0.22	-0.28	-0.38	-0.45	-0.51	-0.56	-0.61	-0.81	-1.34
consumption	0.41	0.77	0.78	0.68	0.59	0.47	0.34	0.21	-0.27	-1.23
investment	-2.79	-4.22	-4.61	-4.88	-4.93	-4.81	-4.62	-4.39	-3.76	-3.24
labour hours	-0.29	-0.22	-0.22	-0.27	-0.27	-0.26	-0.24	-0.22	-0.18	-0.13
FAT Revenues (%GDP)	0.0	0.0	0.0	0.16	0.18	0.20	0.21	0.22	0.21	0.20
Impact on bank variables (deviation from baseline in %)										
volume of loans	-0.51	-1.26	-1.54	-1.54	-1.72	-1.86	-1.94	-2.00	-2.27	-3.22
volume of deposits	2.74	2.25	2.07	3.97	2.59	2.20	1.83	1.47	1.70	1.97
value of bank	-0.66	-1.44	-1.55	-0.86	63.05	75.60	88.20	100.81	72.05	47.22
Impact on bank variables (deviation from baseline in basis points)										
loan rate	-32.42	-21.21	63.00	37.95	35.99	42.49	43.74	42.48	37.61	38.33
deposit rate	-42.01	-37.23	48.05	18.21	-8.10	-7.34	-10.34	-15.07	-1.44	12.93
return on bank equity	-60.62	-72.25	-3.66	-61.42	-100.38	-115.98	-135.79	-157.22	-252.53	-354.15
firm cost of capital	89.68	27.53	-9.54	2.35	11.76	10.88	12.20	14.49	11.85	13.77

Assumption: 50% Modigliani-Miller.

Next, another simulation considers the effect of a 5% FAT coupled with a bank levy of 0.05% on "other liabilities" which are liabilities other than equity and deposits and the regulatory changes. Here again, adding the bank levy only marginally affects macroeconomic variables.

Table (9). The cumulative effect of a 5% point increase of a FAT and a 0.05% Bank Levy (anticipated to be introduced in 2015) and regulatory changes.

	2012	2013	2014	2015	2016	2017	2018	2019	average 2020-2030	long term

Impact on macro variables (deviation from baseline in %)										
GDP	-0.20%	-0.22%	-0.29%	-0.39%	-0.47%	-0.53%	-0.58%	-0.62%	-0.83%	-1.38%
consumption	0.42%	0.79%	0.80%	0.71%	0.61%	0.49%	0.35%	0.22%	-0.27%	-1.27%
investment	-2.84%	-4.33%	-4.75%	-5.04%	-5.09%	-4.97%	-4.78%	-4.54%	-3.91%	-3.34%
labour hours	-0.29%	-0.23%	-0.22%	-0.28%	-0.28%	-0.27%	-0.25%	-0.23%	-0.19%	-0.14%
Bank Levy Revenues (% GDP)	0.0	0.0	0.0	0.07	0.07	0.07	0.07	0.07	0.07	0.07
FAT Revenues (%GDP)	0.0	0.0	0.0	0.18	0.19	0.20	0.21	0.22	0.21	0.21
Impact on bank variables (deviation from baseline in %)										
volume of loans	-0.52%	-1.28%	-1.57%	-1.58%	-1.77%	-1.92%	-2.00%	-2.06%	-2.35%	-3.32%
volume of deposits	2.23%	1.73%	1.53%	3.43%	2.04%	1.65%	1.29%	0.92%	1.13%	1.33%
value of bank	-0.66%	-1.45%	-1.58%	-0.91%	62.97%	75.51%	88.10%	100.69%	71.92%	47.07%
Impact on bank variables (deviation from baseline in basis points)										
loan rate	-33.28	-21.93	63.36	38.53	37.09	43.93	45.03	43.77	38.95	39.58
deposit rate	-42.30	-37.46	48.42	15.26	-10.63	-9.61	-12.71	-17.44	-3.79	10.53
return on bank equity	-60.62	-72.25	-3.66	-61.42	-100.38	-115.98	-135.79	-157.22	-252.53	-354.15
firm cost of capital	89.79	26.91	-10.66	3.10	12.10	11.14	12.48	14.78	12.24	14.31

Assumption: 50% Modigliani-Miller.

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Appendix: Detailed Results Sensitivity Analysis

FAT: High deposit elasticity

	2012A	2013A	2014A	2015A	2020A	2050A	2150A
YDA	-0.04	-0.05	-0.07	-0.09	-0.17	-0.40	-0.47
IDA	-0.66	-1.06	-1.21	-1.29	-1.27	-1.15	-1.11
CDA	0.11	0.20	0.21	0.19	0.06	-0.33	-0.44
KDA	-0.01	-0.05	-0.10	-0.14	-0.35	-0.93	-1.11
LODA	-0.11	-0.29	-0.38	-0.40	-0.57	-1.01	-1.14
DDA	-5.26	-5.39	-5.46	-5.47	-5.75	-7.07	-11.69
VBDA	-0.12	-0.30	-0.36	-0.41	-0.57	-1.01	-1.14
RBDA	-5.60	-3.95	8.85	-3.11	-1.96	-0.46	-0.00
RDDA	-5.89	-4.20	8.59	-3.40	-2.16	-0.41	0.11
REDA	-5.60	-3.95	8.85	-3.11	-1.96	-0.46	-0.00
RLODA	-8.59	-6.13	12.47	8.38	10.20	12.76	13.52
SPREAD	-2.70	-1.93	3.88	11.78	12.35	13.17	13.41
CCSHADOWDA	17.09	3.08	-2.16	2.82	2.48	4.82	5.53
LDA	-0.05	-0.05	-0.05	-0.06	-0.06	-0.05	-0.04
TLEVYDA	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TFATYDA	0.00	0.00	0.00	0.18	0.18	0.18	0.18
TCITYDA	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Levy: High deposit elasticity

	2012A	2013A	2014A	2015A	2020A	2050A	2150A
YDA	-0.01	-0.01	-0.02	-0.03	-0.05	-0.12	-0.14

IDA	-0.19	-0.30	-0.35	-0.37	-0.36	-0.33	-0.32
CDA	0.03	0.06	0.06	0.05	0.02	-0.09	-0.13
KDA	-0.00	-0.01	-0.03	-0.04	-0.10	-0.27	-0.32
LODA	-0.03	-0.08	-0.11	-0.12	-0.16	-0.29	-0.33
BBDA	-0.03	-0.08	-0.11	-0.12	-0.16	-0.29	-0.33
DDA	-3.27	-3.31	-3.34	-3.35	-3.43	-3.82	-5.23
VBDA	-0.04	-0.09	-0.10	-0.12	-0.16	-0.29	-0.33
RBDA	-1.60	-1.12	2.54	-0.89	-0.56	-0.13	-0.00
RDDA	-1.68	-1.20	2.46	-0.97	-0.62	-0.12	0.03
REDA	-1.60	-1.12	2.54	-0.89	-0.56	-0.13	-0.00
RLODA	-2.46	-1.75	3.57	2.40	2.92	3.65	3.87
SPREAD	-0.77	-0.55	1.11	3.37	3.54	3.77	3.84
CCSHADOWDA	4.89	0.88	-0.62	0.81	0.71	1.38	1.58
LDA	-0.02	-0.01	-0.02	-0.02	-0.02	-0.01	-0.01
TLEVYDA	0.00	0.00	0.00	0.08	0.08	0.08	0.08
TFATYDA	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TCITYDA	0.00	0.00	0.00	0.00	0.00	0.00	0.00

FAT: High share of fixed labour

	2012A	2013A	2014A	2015A	2020A	2050A	2150A
YDA	-0.02	-0.03	-0.05	-0.06	-0.11	-0.25	-0.28
IDA	-0.42	-0.69	-0.79	-0.84	-0.82	-0.70	-0.67
CDA	0.07	0.13	0.13	0.12	0.03	-0.21	-0.28
KDA	-0.01	-0.03	-0.06	-0.09	-0.23	-0.58	-0.67
LODA	-0.07	-0.18	-0.25	-0.26	-0.37	-0.63	-0.69
DDA	-0.13	-0.18	-0.21	-0.21	-0.27	-0.44	-0.48
VBDA	-0.07	-0.18	-0.23	-0.27	-0.37	-0.63	-0.69

RBDA	-1.96	-0.98	4.83	-2.19	-1.39	-0.29	-0.00
RDDA	-2.64	-1.87	3.80	-3.21	-2.62	-2.01	-1.86
REDA	-1.96	-0.98	4.83	-2.19	-1.39	-0.29	-0.00
RLODA	-5.44	-3.90	7.62	5.53	6.72	7.90	8.20
SPREAD	-2.80	-2.03	3.82	8.74	9.34	9.91	10.06
CCSHADOWDA	9.74	1.05	-0.91	1.87	1.66	3.01	3.36
LDA	-0.03	-0.03	-0.04	-0.04	-0.04	-0.03	-0.02
TLEVYDA	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TFATYDA	0.00	0.00	0.00	0.17	0.17	0.17	0.17
TCITYDA	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Levy: High share of fixed labour

	2012A	2013A	2014A	2015A	2020A	2050A	2150A
YDA	-0.01	-0.02	-0.03	-0.03	-0.06	-0.14	-0.16
IDA	-0.24	-0.40	-0.45	-0.47	-0.46	-0.41	-0.39
CDA	0.04	0.07	0.07	0.07	0.02	-0.12	-0.16
CLDA	0.12	0.11	0.12	0.12	0.08	-0.04	-0.07
KDA	-0.01	-0.02	-0.04	-0.05	-0.13	-0.34	-0.39
LODA	-0.04	-0.11	-0.14	-0.15	-0.21	-0.36	-0.40
DDA	0.02	-0.01	-0.03	-0.02	-0.06	-0.15	-0.18
VBDA	-0.04	-0.11	-0.14	-0.15	-0.21	-0.36	-0.40
RBDA	-1.26	-0.77	2.03	-1.10	-0.77	-0.17	-0.00
RDDA	-1.27	-0.90	1.84	-1.29	-1.07	-0.74	-0.65
REDA	-1.26	-0.77	2.03	-1.10	-0.77	-0.17	-0.00
RLODA	-3.11	-2.22	4.48	3.25	3.77	4.56	4.78
SPREAD	-1.84	-1.32	2.64	4.54	4.85	5.30	5.42

ZETADA	14.61	4.74	-7.64	-3.81	-4.74	-4.71	-4.70
CCSHADOWDA	5.66	0.63	-0.11	0.96	0.93	1.73	1.95
LDA	-0.02	-0.02	-0.02	-0.02	-0.02	-0.01	-0.01
TLEVYDA	0.00	0.00	0.00	0.08	0.08	0.08	0.08
TFATYDA	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TCITYDA	0.00	0.00	0.00	0.00	0.00	0.00	0.00

B. Securities Transaction Tax in a DSGE Framework

1. INTRODUCTION

This section presents a dynamic stochastic general equilibrium (DSGE) model that can be used as an instrument of qualitative assessment of some of the consequences of the introduction of a securities transaction tax (STT) in an economy. The novelty of the approach lies in the emphasis given to the macroeconomic effects the tax could have and in particular in its potential for capturing some of the endogenous channels via which such effects could emerge. This contrasts our setting with more standard partial equilibrium approaches (see e.g. Kupiec, 1996, Song & Zhang, 2005), which by construction exclude many of these channels.

Our work contributes to the long (and so far inconclusive) debate on the pros and cons of the STT. A comprehensive overview of the state of this debate can be found e.g. in Matheson (2011). At this place we briefly outline the main arguments.

Pros:

1.) Correcting distortions: The Securities Transaction Tax (henceforth: STT) may reduce short-term speculative trading, thereby limiting the waste of resources, market volatility and asset mispricing.

2.) Raising revenue: The STT raises public revenues and makes the financial sector contribute to the expenses incurred through the banking and financial crisis. Given its broad tax base, the STT may collect substantial revenue at low rates.

Cons:

3.) The short-term trading the STT is meant to eliminate is not proven to be detrimental to price recovery. Neither is there a clear link between short-term trading and long-run cycles of asset mispricing (bubbles). On the contrary, the instruments which led to the 2008 financial crisis do not belong to the set of frequently traded instruments. Moreover, asset bubbles have historically also occurred in markets with high transaction costs (real estate), suggesting that a low-rate STT will not prevent them in the future.

4.) The STT is too crude to target "undesirable" short-term trading. Since all transactions are taxed at equal rates and independent of their risk profile, the STT does not target risk-taking and financial sector fragility.

5.) The STT may lead to a drop in share prices and thereby to an increase in firms' costs of raising capital.

6.) The impact of an STT on the market volatility is not clearcut. The STT may eventually increase share price volatility by reducing liquidity (i.e., trading volume) in the markets and may result into sharper rather than smoother price movements. In general, individual transactions cause larger price fluctuation in thinner markets.

7.) – The tax base of the STT is very elastic. As there are many ways to avoid the tax (incl. creation of new instruments, mobility across market segments and market), effective imposition might require the tax to be introduced on the broadest possible base and in internationally co-ordinated ways.

Our model enters this debate by addressing points 1, 2, 5 and 6. In addition, the general equilibrium model is a valuable complement of the existing approaches by allowing the assessment of feedback effects in the entire economy.

2. THE MODEL

In this note, we study the impact of the introduction of a STT on the economy. For this purpose, we incorporate financial frictions in an otherwise standard closed economy real-business-cycle model. We depart from the usual assumptions along two dimensions.

First, we allow for a 'trader' sector, which is engaged in short-term trading in risk-free and risky financial assets: government bonds and corporate shares, respectively. A fraction of traders is assumed to be 'noise traders' à la De Long et al. (1989): their expectations about future stock returns are noisy in the sense that they may deviate from the rational expectations which are based on economic fundamentals. The non-fundamental shocks hitting the expectations of noise-traders lead to an increased volatility of asset prices.

Second, firms financing is subject to a collateral constraint. In particular, we assume that firms' investment expenditure cannot exceed a given fraction of the firms' outstanding share value. This feature captures in a stylized manner the link between firms' share price and their financing.

In the model, it is assumed that long-lived households own a fixed share of total stocks. They are specified as long-term investors and do not engage in short-term trading. In contrast, both types of traders have a short (2-period) horizon, which further reinforces the speculative character of their financial activities. Traders borrow on the risk-free credit market and invest in risky assets. In the following period, they earn the returns on their risky investment and pay back their debt including (risk-free) interests.

The short–term trading generates transaction costs in terms of limited resources (money, time etc.) which are assumed to be 'wasted'. This captures the aggregate inefficiency due to short-term speculative trading. The structure of the model allows imposing a tax on these transactions (STT) in order to analyze its potentially corrective role.

Share prices are determined in the model as the future discounted flow of dividends. In contrast to standard models, the discount factor used in the evaluation of share prices is that of

the short-term investors; thereby, the share price is influenced by the noise shock (positively) as well as the transaction costs and potentially the STT (negatively). By contrast, firms base their investment decisions on long-term investors' discount factor. Since these investors are, by assumption, not influenced by either of the previously mentioned factors, there may be differences between the return on the share in the secondary financial markets and the cost of capital (defined as the return on capital).

The model uses a closed-economy framework and assumes the STT to be effectively implementable and enforceable. In other words, the analysis abstracts from the issue of tax evasion in an open economy with integrated financial markets. It also excludes other important classes of risky assets, in particular derivatives, which cannot be easily incorporated into a general equilibrium model. The appendix to this note presents a detailed description of the model.

3. DYNAMICS OF THE MODEL

The model incorporates two main shocks that influence the economy. One is a total factor productivity (TFP) shock, which in the standard DSGE framework explains an important part of economic fluctuations at business cycle frequencies. The other is the noise shock introduced in section 2, which drives the deviations of the noise traders' expectations from the fundamentals. It is implemented as a shock to the expectations about future returns on the risky asset (shares) and directly affects only the generation of traders entering the market in the period of the shock.[12] The dynamics of the economy hit by each of these disturbances is sketched below.

3.1. Real shock: TFP

The impact of a TFP shock in the model is fairly standard. A positive TFP shock raises the return on capital as well as the marginal productivity of labour. Investment, capital stock, share prices, real wages, output and consumption increase. The income effect leads to a decline in employment as households choose to spend more of their available time on leisure. The productivity shock and the associated expectations of higher returns on capital lead to an immediate jump in the firm's value and share price. Traders' earnings increase in the period of the shock. Aggregate consumption is more volatile than in the baseline RBC model as traders do not smooth consumption from the additional income over time.

3.2. Noise shock

A positive shock of this type propagates in the economy via two channels. First, it directly affects the demand for risky assets on the side of the new generation of noise traders. This has several consequences. Share prices and current returns on risky assets increase on impact. The affected noise traders, in order to finance their increased risky asset positions, resort to more borrowing from the long-lived households, driving up also the risk-free interest rate. Reacting to this incentive, long-lived consumers reduce their consumption and increase savings. There

[12] The expectations of the previous generation of traders, who in the current period liquidate the asset positions made one period earlier, do not matter.

are also some redistributive effects across the generations of traders: the previous generation of traders, which liquidates its shares position in the period of the shock, benefits from increased asset market earnings, which boosts its consumption. In contrast, the overly optimistic current traders' generation has to pay an elevated price on its borrowing next period. Combined with returns on shares that are lower than expected as well as with higher than usual transaction costs, they have to lower their consumption. Overall, noise shocks working via the demand channel increase the volatility of (both risky and risk-free) asset prices and returns and the volatility of the aggregate consumption.

The second propagation channel of the noise shock affects the behaviour of the production sector. Since the amount of firms' investment is limited by the stock market value of the firm (as reflected by the share prices), volatility on the stock market has a direct effect on the firms' investment decisions, and hence on output. This effect is accelerated by changes in the risk-free interest rate. Hence, noise shocks lead to further increases in the volatility of the main aggregates in the economy.

4. INTRODUCING SECURITIES TRANSACTION TAX

The mechanisms described in section 3.2 lead to the emergence of non-trivial inefficiencies in the economy. In this section a simple experiment is made to assess whether the introduction of an SST can help in attenuating these inefficiencies. We also discuss the potential for the emergence of other inefficiencies linked to the introduction of the SST (by increasing the cost of capital).

The STT is imposed on traders' risky investment and has to be paid in addition to the transaction cost. While the transaction costs are pure waste, the STT is paid to the government and transferred to long-lived households in form of a lump-sum payment.

The impact of the introduction of an STT on financial variables and economic aggregates is summarised in Table 1. The 'mean' corresponds to the steady-state per-capita level of the given variable. The volatilities are generated by simultaneous randomly generated TFP and noise shocks which are assumed to be uncorrelated. For the benchmark no-STT case, we also highlight in the table the share of total volatility specifically generated by the noise shock. The standard deviation of the TFP shock is calibrated in line with the DSGE literature. The standard deviation of the noise shock is such that the annualized volatility of the return on shares is close to its empirical values. In the baseline calibration STT was set so that the implicit tax rate (the ratio of the tax revenue to the tax base) was around 20 basis points (see the header of the 'STT' part of Table 1). This corresponds to revenue raised with the tax of 0.16% of GDP on average. These values are close to historical tax rates and revenues raised in G-20 countries over the last two decades; see Matheson, 2010.

Two main effects of the STT can be pointed out:

First, in the long run (see the 'mean' columns in table 1), the introduction of an STT leads to a reduction of the share price and an increase in share returns. The return on capital also increases, which implies higher financing costs for firms. As a result, investment and the stock of productive capital fall. Correspondingly, output, consumption and employment all

decline in the long-run as well. Moreover, the size of this restrictive impact of the STT is sizeable according to our model.

Table 1: Stochastic simulation results without and with STT

	NO STT			**STT** (implicit tax rate: 20 bp)		**CHANGE**	
variable	***mean***	***std/mean (%)***		***mean***	***std/mean (%)***	***mean (%)***	***std/mean (pp)***
		total	of which noise				
output	1.00	2.77	0.29	0.97	2.75	-3.43	-0.03
capital	8.18	1.75	0.01	7.47	1.74	-8.67	-0.01
investment	0.20	3.62	1.10	0.19	3.60	-8.68	-0.02
consumption	0.70	3.76	0.98	0.69	3.65	-2.26	-0.11
employment	0.61	1.94	1.60	0.61	1.86	-0.34	-0.08
wage	3.60	2.83	0.08	3.49	2.82	-3.09	0.00
share price	4.13	3.86	1.33	3.77	3.81	-8.67	-0.05
return on share	3.01	3.10	2.50	3.41	3.04	0.40	-0.06
risk-free return	1.01	4.25	3.94	1.01	4.06	0.00	-0.19
return on capital	4.02	1.81	0.01	4.22	1.80	0.20	-0.02
STT revenues/GDP	0.00			0.16		0.16	
transactions costs/GDP	0.83	3.85	2.99	0.78	3.76	-0.04	-0.09

Note: Output in the benchmark (no STT) version is normalised to one. Other real aggregates are shares (or multipliers) of the benchmark output. Returns are reported in quarterly percentage points. STT revenues and transaction costs are shown as % of GDP. The volatility (standard deviation / mean) is expressed as % of the given variable with the exception of the returns as well as the revenue and transaction cost ratios, where it is expressed in percentage points. Similarly, changes in mean are % changes with respect to no-STT levels, except for returns as well as revenues and transaction costs (expressed in percentage points). Changes in volatility are all in percentage points.

Second, the STT reduces the profitability of buying shares when expected returns increase and selling them afterwards. Therefore, it helps containing noise-traders' activity and thereby also the standard deviation of the share price driven by short-term noise trading. Since the volatility of the share price matters for firms via the financing constraint, the volatility of

investment and the overall output volatility can also be reduced. However, the order of magnitude of changes in volatility implied in the model is found to be fairly small. Therefore, the long-run negative impact of the STT seems to outweigh the gain in terms of volatilities.

Sensitivity analysis

In this subsection, we check the robustness of the above results to different tax rates and to different shares of noise traders.

Tax rates

In the benchmark version STT is calibrated so as to raise a revenue of 0.1 – 0.2% of GDP in line with historical values. If instead tax rates are given and tax revenue is calculated within the model, STT rates of 1 and 10bp, would not raise more than 0.1% of GDP tax revenues in the model; such rates would also be insufficient to contain the negative impact of short-term noise trading, while already leading to non-negligible real losses (see Tables A.1 and A.2 in the Appendix).

The share of noise traders

The above results were produced under the assumption that half the share of all the traders are noise traders, sn=0.5. In the Appendix results for sn=0.75 (only a quarter of traders are informed, see Table A.3) and sn=0.25 (see Table A.4) are reported. As is clearly visible from comparison of the tables, the effects of the introduction of an STT in the economy remain qualitatively similar regardless of the assumed share of noise traders. Moreover, the long-run behaviour of macroeconomic and financial variables is quantitatively identical independent of the number of noise traders. On the other hand, an increase in the number of noise traders leads to an increased volatility of most variables, and in some cases (investment) this effect is sizeable. With more numerous noise traders, the attenuating effect of the introduction of the STT on the volatility in the economy tends to be larger as well.

5. DISCUSSION

To the best of our knowledge, very little theoretical work has been done to assess the impact of the introduction of an STT on the real economy. The few existing models studying STT in the presence of noise traders apply only partial equilibrium analysis (see Kupiec, 1996 or Song & Zhang, 2005). Xu (2009) studies the impact of financial transaction tax in a general equilibrium model with noise traders; however, she focuses on foreign currency transaction tax as opposed to the securities transaction tax which is the focus of this note.

Also, earlier theoretical assessments of the impact of the STT on the share price and on the cost of capital are rather scarce. The few notable examples are Matheson, 2010 and Rene M. Stulz's Discussion of Campbell and Froot, 1994. Matheson uses a simple formula for the assessment of the effect of STT on the share price which allows a partial equilibrium assessment of the long-run impact of the STT on the share price, given assumptions about the interest rate and the average holding period and assuming that dividends (and hence

everything else in the real economy, incl. the cost of capital) remain constant; see p. 14 and the Appendix in Matheson (2011).

Since this formula does not allow the author to create a link between the STT and firms' decision making, or put differently between the STT and the cost of capital, Matheson develops a formula for the cost of capital for which he assumes an ad-hoc link noting that the 'STT acts like a permanently increasing dividend tax rate' (p. 40, Appendix, Matheson, 2011). He thus assumes that the STT directly enters firms' decision problem and hence directly influences the cost of capital. This approach has two shortcomings. First, in reality, there is no reason to assume that firms directly take the STT into consideration, since in most countries where STT exists it is not introduced on the primary asset market. Second, this approach is not sufficient to capture the link between the price of shares traded in the secondary market and the value of capital, i.e. firms' decisions. In particular, it is not useful in capturing the impact on firms of share price volatility caused by non-fundamental factors like noise trading considered in this model.

In contrast to Matheson's two loosely linked formulas for the share price and the cost of capital, respectively, the model we presented explains the impact of the STT on share prices in a coherent general equilibrium model and, in addition, it explicitly introduces a plausible link between the share price and firms' decisions via the financing constraint of firms. This allows us to capture the long-run impact of an STT on the share price and economic aggregates and thereby it also creates a – less than proportional - link between variations in the share returns and variations in the cost of capital.

Long-run negative effect of STT:

Our model predicts a sizeable long-run negative impact of an STT on the real economy via firms' financing channel. The change in the share price generated by our model is fairly close to, though somewhat below the one implied by the Matheson formula for the share price under similar assumptions about the tax rate and the holding period. The difference is likely to be explained by endogenous changes in other variables predicted by our general equilibrium model, which are not captured in the Matheson formula.

As regards our predictions for the cost of capital, the impact of the STT implied by our model is somewhat smaller than the Matheson-type formula for the cost of capital would show for the same tax rates and holding periods. This difference should be to a large extent attributable to the less direct link between the STT and the cost of capital in our general equilibrium model.

Impact on Volatility:

We find a rather modest impact of the STT on the volatility of the share price and on the volatility of real economic aggregates. This result is similar to the one reported by Xu (2009) for the effect of the introduction of a Tobin's tax in foreign exchange markets. It should be mentioned that our model does not capture the effect of falling liquidity on share price volatility; this is likely to decrease the volatility gains of the STT even further.

Caveats and possible future extensions:

Due to the complexity of modelling trade in financial assets in DSGE models, a number of features could not be addressed in the model which would be relevant for the debate.

First, there is no derivatives market in the model and it is assumed that STT is effectively implementable and enforceable. Therefore, the model cannot be used to answer questions about the taxation of derivatives; it cannot be used either to study changes in the market structure (spot vs. derivatives markets) if only the spot market transactions were taxed. A potential extension could however introduce various spot market assets to assess the elasticity of the tax base if only one of the instruments were taxed.

Second, we use a closed-economy model. This does not allow us to assess cross-border capital mobility and the relocation effects of the STT neither. It could be in principle possible to consider an open economy version of the model to address this issue. However, such a project would involve new technical challenges implying modelling tasks well beyond the current state-of-the-art frameworks.

Overall, the more possibilities financial markets have to avoid the tax, the lower the revenues that can be raised by the tax and the lower the direct impact on the economy would be. At the same time, the STT itself may lead to non-trivial changes in the structure of financial markets with potential economic consequences which are difficult to foresee.

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Appendix

Table A.1. Stochastic simulation without and with STT – implicit tax rate: 1bp

	NO STT		**STT** (implicit tax rate: 1bp)		**CHANGE**	
variable	***mean***	***std/mean (%)***	***mean***	***std/mean (%)***	***mean %***	***std/mean (pp)***
output	1.00	2.77	1.00	2.78	-0.17	0.00
capital	8.18	1.75	8.14	1.75	-0.47	0.00
investment	0.20	3.62	0.20	3.64	-0.51	0.02
consumption	0.70	3.76	0.70	3.77	-0.12	0.00
employment	0.61	1.94	0.61	1.94	-0.03	0.00
wage	3.60	2.83	3.59	2.83	-0.16	0.00
share price	4.13	3.86	4.11	3.86	-0.47	0.00
return on share	3.01	3.10	3.03	3.09	0.02	-0.01
risk-free return	1.01	4.25	1.01	4.24	0.00	-0.01
return on capital	4.02	0.07	4.03	0.07	0.01	0.00
STT revenues/GDP	0.00		0.01		0.01	
transactions costs/GDP	0.83	3.85	0.82	3.85	0.00	0.00

Table A.2. Stochastic simulation without and with STT – implicit tax rate: 10bps

	NO STT		**STT** (implicit tax rate: 10 bp)		**CHANGE**	
variable	***mean***	***std/mean (%)***	***mean***	***std/mean (%)***	***mean %***	***std/mean (pp)***
output	1.00	2.77	0.98	2.75	-1.76	-0.02
capital	8.18	1.75	7.81	1.75	-4.50	-0.01
investment	0.20	3.62	0.20	3.62	-4.55	0.00
consumption	0.70	3.76	0.69	3.71	-1.16	-0.06
employment	0.61	1.94	0.61	1.89	-0.20	-0.05

wage	3.60	2.83	3.54	2.82	-1.58	0.00
share price	4.13	3.86	3.95	3.83	-4.50	-0.03
return on share	3.01	3.10	3.21	3.06	0.20	-0.04
risk-free return	1.01	4.25	1.01	4.15	0.00	-0.10
return on capital	4.02	0.07	4.12	0.07	0.10	0.00
STT revenues/GDP	0.00		0.08		0.08	
transactions costs/GDP	0.83	3.85	0.80	3.80	-0.02	-0.05

Note: Output in the benchmark (no STT) version is normalised to one. Other real aggregates are shares (or multipliers) of the benchmark output. Returns are reported in quarterly percentage points. STT revenues and transaction costs are shown as % of GDP. The volatility (standard deviation / mean) is expressed as % of the given variable with the exception of the returns as well as the revenue and transaction cost ratios, where it is expressed in percentage points. Similarly, changes in mean are % changes with respect to no-STT levels, except for returns as well as revenues and transaction costs (expressed in percentage points). Changes in volatility are all in percentage points.

Table A.3. Stochastic simulation without and with STT – high share of noise traders

	NO STT		**STT** (implicit tax rate: 20 bp)		**CHANGE**	
variable	***mean***	***std/mean (%)***	***mean***	***std/mean (%)***	***mean %***	***std/mean (pp)***
output	1.00	3.10	0.97	3.03	-3.43	-0.07
capital	8.18	1.76	7.47	1.75	-8.67	-0.01
investment	0.20	4.72	0.19	4.52	-8.68	-0.20
consumption	0.70	4.72	0.69	4.50	-2.26	-0.22
employment	0.61	2.89	0.61	2.76	-0.34	-0.13
wage	3.60	2.93	3.49	2.92	-3.09	-0.01
share price	4.13	5.05	3.77	4.97	-8.67	-0.09
return on share	3.01	4.61	3.41	4.52	0.40	-0.09
risk-free return	1.01	6.37	1.01	6.08	0.00	-0.29
return on capital	4.02	2.08	4.22	0.09	0.16	-1.99
STT revenues/GDP	0.00		0.16		0.16	
transactions costs/GDP	0.83	5.69	0.78	5.57	-0.04	-0.12

Table A.4. Stochastic simulation without and with STT – low share of noise traders

	NO STT		**STT** (implicit tax rate: 20 bp)		**CHANGE**	
variable	***mean***	***std/mean (%)***	***mean***	***std/mean (%)***	***mean %***	***std/mean (pp)***
output	1.00	2.57	0.97	2.55	-3.43	-0.02
capital	8.18	1.75	7.47	1.74	-8.67	-0.01
investment	0.20	2.86	0.19	2.86	-8.68	0.00
consumption	0.70	3.07	0.69	3.02	-2.26	-0.05
employment	0.61	1.01	0.61	0.96	-0.34	-0.05
wage	3.60	2.76	3.49	2.77	-3.09	0.00
share price	4.13	2.92	3.77	2.90	-8.67	-0.02

return on share	1.03	1.61	3.41	1.59	2.38	-0.02
risk-free return	1.01	2.14	1.01	2.04	0.00	-0.10
return on capital	4.02	0.07	4.22	0.07	-3.86	0.00
STT revenues/GDP	0.00		0.16		0.16	
transactions costs/GDP	0.83	2.06	0.78	2.02	-0.04	-0.04

Note: Output in the benchmark (no STT) version is normalised to one. Other real aggregates are shares (or multipliers) of the benchmark output. Returns are reported in quarterly percentage points. STT revenues and transaction costs are shown as % of GDP. The volatility (standard deviation / mean) is expressed as % of the given variable with the exception of the returns as well as the revenue and transaction cost ratios, where it is expressed in percentage points. Similarly, changes in mean are % changes with respect to no-STT levels, except for returns as well as revenues and transaction costs (expressed in percentage points). Changes in volatility are all in percentage points.

1 Model Description

1.1 Households

There are two types of households. A share s_l are the standard infinitely-living households: they consume, work and own a fixed fraction of firms' shares on which they earn dividends. The remaining $1 - s_l$ fraction are short-horizon financial traders. They borrow from the long-lived households at the riskfree interest rate and invest the money borrowed in the risky asset. In the following period, they earn the dividends and sell their assets from which they reimburse their debt including the interest payment and consume the rest. In addition, it is assumed that a share s_n of traders are so-called 'noise-traders': their expectations about the future share return are noisy in the sense that they may deviate from the rational expectations by a noise shock.

Variables in the model description are all in per capita terms.

1.1.1 Long-lived households:

$$\max_{C_t^l, L_t, B_t^l} E_0 \sum_{t=0}^{\infty} \beta^t \left[\log C_t^l - \frac{\omega}{1+\kappa} L_t^{1+\kappa} \right]$$

subject to:

$$C_t^l + B_t^l = \left(1 - \tau^l\right) W_t L_t + R_{t-1} B_{t-1}^l + DIV_t a_{t-1}^l - T_t^{ls},$$

where C_t^l is the long-lived households' (per capita) consumption, B_t^l their risk-free asset holding and a_t^l their stock holding which is constant: $a_t^l = \frac{\theta}{s_l}$. DIV_t denotes dividends paid in period t, R_{t-1} the gross risk-free interest rate fixed in $t-1$ and paid in t. L_t is hours worked per person in the household, W_t denotes the wage and τ^l the labour income tax. T_t^{ls} stands for lump-sum taxes.

1.1.2 Traders:

$$\max_{C_t^{T,j}, a_t^{T,j}} \beta E_t^j \log C_{t+1}^{T,j}$$

subject to:

$$E_t^j C_{t+1}^{T,j} = \bar{w} + E_t^j \left(P_{t+1}^{sh} + DIV_{t+1}\right) a_t^{T,j} - R_t P_t^{sh} a_t^{T,j} - \frac{c + \tau^{FTT}}{2} P_t^{sh} \left(a_t^{T,j}\right)^2 - T_t^{ls,T}$$

where $j = I, N$ is standing for informed traders and noise traders, respectively. $C_{t+1}^{T,j}$ is traders' consumption, $a_t^{T,j}$ is their asset holding. P_t^{sh} stands for the share price. In addition, traders are assumed to earn a fixed $\bar{w}$ on their wealth which they consume immediately (this is just to avoid zero consumption of traders and does not change anything in the model). Traders may also pay lump-sum taxes $T_t^{ls,T}$.

The share return will be defined as $R_t^{sh} \equiv \frac{P_t^{sh} + DIV_t}{P_{t-1}^{sh}}$.

The expectations of informed traders are rational: $E_t^I R_{t+1}^{sh} = E_t R_{t+1}^{sh}$. The expectations of noise traders only deviate from rational expectations by a random noise shock: $E_t^N R_{t+1}^{sh} = E_t R_{t+1}^{sh} + \nu_t$, $\nu_t \sim N\left(\nu^*, \sigma_\nu\right)$.

The cost c is standing for transaction costs unrelated to taxes. It is treated as waste in the model. The financial transaction tax increases costs related to trading. The only difference compared to the 'wasted' transaction costs is that the tax raises revenue for the government budget.

Total traders' consumption is $C_t^T = \left(1 - s_n\right) C_t^{T,I} + s_n C_t^{T,N}$.
Total traders' stock holding is: $a_t^T = \left(1 - s_n\right) a_t^{T,I} + s_n a_t^{T,N}$.

1.2 Firms:

Firms maximise the future discounted flow of dividends by taking optimal decisions about employment, capital stock K_t and investment I_t. They may face employment and investment adjustment costs. They take into account the discount factor of long-lived households (who own the majority of the firms' stocks). Formally:

$$\max_{L_t, K_t, I_t} \sum_{t=0}^{\infty} \beta \frac{\lambda_t^l}{\lambda_0^l} DIV_t$$

subject to:

$$DIV_t = (1-\tau^c)\left(Y_t - W_t s_l L_t - \frac{\gamma_l}{2}\left(L_t - L_{t-1}\right)^2 - \frac{\gamma_i}{2}\left(\frac{I_t}{K_{t-1}} - \delta\right)^2 K_{t-1}\right) + \tau^c \delta K_{t-1} - I_t,$$

where τ^c stands for the corporate income tax. λ_t^l is the Lagrange multiplier of the long-lived households' budget constraint.

The production technology:

$$Y_t = A_t \left(K_{t-1}\right)^{1-\alpha} \left(s_l L_t\right)^{\alpha}.$$

The capital accumulation equation:

$$K_t = (1-\delta) K_{t-1} + I_t.$$

The financing constraint for investment:

$$I_t \leqslant \phi \beta E_t \left[\frac{\lambda_{t+1}^l}{\lambda_t^l} P_{t+1}^{sh}\right].$$

The Lagrange multiplier of the collateral constraint (in terms of consumption utils) is denoted by μ_t. The same for the capital accumulation equation is denoted by Q_t.

Note: For the optimisation problem, P_{t+1}^{sh} is considered to be exogenous for the firm [I don't know how innocuous this assumption is].

1.3 Government:

Budget constraint (debt accumulation equation):

$$\begin{aligned}\frac{B_t^G}{R_t} &= B_{t-1}^G + G_t - \tau^l s_l W_t L_t - s_l T_t^{ls} - (1-s_l) T_t^{ls,T} - \tau^c \left(Y_t - W_t s_l L_t\right) + \tau^c \delta K_{t-1} - \\ &\quad - (1-s_l) \frac{\tau^{FTT}}{2} P_{t-1}^{sh} \left((1-s_n)\left(a_{t-1}^{T,I}\right)^2 + s_n \left(a_{t-1}^{T,N}\right)^2\right)\end{aligned}$$

where B_t^G denotes the public debt and G_t is (exogenous) government consumption.

The debt rule:

$$T_t^{ls} = T_{t-1}^{ls} + \alpha^{Tls}\left(\frac{B_t^G}{Y_t} - \overline{BY}\right)$$

where $\overline{BY}$ denotes the target debt-to-GDP ratio.

1.4 Equilibrium:

In equilibrium, all markets clear. This implies the following conditions:

1.4.1 Stock market:

$$a_t = s_l a_t^l + (1 - s_l)\, a_t^T = 1$$

from which:

$$a_t^T = \frac{1-\theta}{1-s_l}.$$

1.4.2 Bond market:

$$B_t^l = \frac{1}{s_l}\left(\frac{B_t^G}{R_t} + (1 - s_l)\, P_t^{sh} a_t^T\right).$$

1.4.3 Goods market:

Total traders' consumption is $C_t^T = (1 - s_n)\, C_t^{T,I} + s_n C_t^{T,N}$.
Total households' consumption is: $C_t = s_l C_t^l + (1 - s_l)\, C_t^T$.

The goods market equilibrium condition is:

$$\begin{aligned} Y_t &= C_t + G_t + I_t + \frac{\gamma_l}{2}\left(L_t - L_{t-1}\right)^2 + \frac{\gamma_i}{2}\left(\frac{I_t}{K_{t-1}} - \delta\right)^2 K_{t-1} + \\ &\quad + (1 - s_l)\,\frac{c}{2} P_{t-1}^{sh}\left((1 - s_n)\left(a_{t-1}^{T,I}\right)^2 + s_n\left(a_{t-1}^{T,N}\right)^2\right) - (1 - s_l)\,\bar{w}. \end{aligned}$$

2 First-order conditions:

2.1 Households:

2.1.1 Long-lived households:

$$\frac{-U_t^L}{U_t^{C,l}} = \left(1-\tau^l\right) W_t$$

$$\lambda_t^l = \beta R_t E_t \lambda_{t+1}^l$$

$$U_t^L = \omega L_t^\kappa$$

$$U_t^{C,l} = \frac{1}{C_t^l}$$

$$\lambda_t^l = U_t^{C,l}$$

2.1.2 Trader households:

$$E_t \frac{1}{C_{t+1}^{T,I}} a_t^{T,I} \left(c+\tau^{FTT}\right) = E_t \left[\frac{1}{C_{t+1}^{T,I}} \left(R_{t+1}^{sh} - R_t\right)\right]$$

$$E_t^N \frac{1}{C_{t+1}^{T,N}} a_t^{T,I} \left(c+\tau^{FTT}\right) = E_t^N \left[\frac{1}{C_{t+1}^{T,N}} \left(R_{t+1}^{sh} - R_t\right)\right]$$

$$R_t^{sh} = \frac{P_t^{sh} + DIV_t}{P_{t-1}^{sh}}$$

$$C_t^{T,I} = \bar{w} + \left(P_t^{sh} + DIV_t\right) a_{t-1}^{T,I} - R_{t-1} P_{t-1}^{sh} a_{t-1}^{T,I} - \frac{c+\tau^{FTT}}{2} P_{t-1}^{sh} \left(a_{t-1}^{T,I}\right)^2 - T_{t-1}^{ls,T}$$

$$C_t^{T,N} = \bar{w} + \left(P_t^{sh} + DIV_t\right) a_{t-1}^{T,N} - R_{t-1} P_{t-1}^{sh} a_{t-1}^{T,N} - \frac{c+\tau^{FTT}}{2} P_{t-1}^{sh} \left(a_{t-1}^{T,N}\right)^2 - T_{t-1}^{ls,T}$$

$$E_t^N R_{t+1}^{sh} = E_t R_{t+1}^{sh} + \nu_t$$

$$E_t^N C_{t+1}^{T,N} = E_t C_{t+1}^{T,N} + \nu_t P_t^{sh} a_t^{T,N}$$

2.1.3 Aggregations:

$$a_t^T = (1 - s_n)\, a_t^{T,I} + s_n a_t^{T,N}$$

$$a_t^T = \frac{1-\theta}{1-s_l}$$

$$B_t^l = \frac{1}{s_l}\left(\frac{B_t^G}{R_t} + (1 - s_l)\, P_t^{sh} a_t^T\right)$$

$$B_t^T = P_t^{sh} a_t^T$$

$$C_t^T = (1 - s_n)\, C_t^{T,I} + s_n C_t^{T,N}$$

$$C_t = s_l C_t^l + (1 - s_l)\, C_t^T$$

2.2 Firms:

$$Y_t = A_t \left(K_{t-1}\right)^{1-\alpha} \left(s_l L_t\right)^{\alpha}$$

$$DIV_t = (1 - \tau^c)\left(Y_t - W_t s_l L_t - \frac{\gamma_l}{2}\left(L_t - L_{t-1}\right)^2 - \frac{\gamma_i}{2}\left(\frac{I_t}{K_{t-1}} - \delta\right)^2 K_{t-1}\right) + \tau^c \delta K_{t-1} - I_t,$$

$$K_t = (1 - \delta)\, K_{t-1} + I_t$$

$$I_t = \phi\beta E_t\left[\frac{\lambda_{t+1}^l}{\lambda_t^l} P_{t+1}^{sh}\right]$$

$$\alpha\frac{Y_t}{s_l L_t} = W_t + \gamma_l\left(L_t - L_{t-1}\right) - \beta E_t\left[\frac{\lambda_{t+1}^l}{\lambda_t^l}\gamma_l\left(L_{t+1} - L_t\right)\right]$$

$$Q_t = \beta E_t \frac{\lambda_{t+1}^l}{\lambda_t^l}\left[(1 - \tau^c)\,(1 - \alpha)\,\frac{Y_{t+1}}{K_t} + \tau^c\delta + (1 - \delta)\, Q_{t+1}\right]$$

$$Q_t = 1 + \gamma_i\left(\frac{I_t}{K_{t-1}} - \delta\right) + \mu_t$$

2.3 Government:

$$\begin{aligned}\frac{B_t^G}{R_t} &= B_{t-1}^G + G_t - \tau^l s_l W_t L_t - s_l T_t^{ls} - (1-s_l)\, T_t^{ls,T} - \tau^c \left(Y_t - W_t s_l L_t\right) + \tau^c \delta K_{t-1} - \\ &\quad - (1-s_l)\, \frac{\tau^{FTT}}{2} P_{t-1}^{sh} \left((1-s_n) \left(a_{t-1}^{T,I}\right)^2 + s_n \left(a_{t-1}^{T,N}\right)^2 \right)\end{aligned}$$

$$T_t^{ls} = T_{t-1}^{ls} + \alpha^{Tls} \left(\frac{B_t^G}{Y_t} - \overline{BY} \right)$$

$$T_t^{ls,T} = -s^T \left[\frac{\tau^{FTT}}{2} P_{t-1}^{sh} \left((1-s_n) \left(a_{t-1}^{T,I}\right)^2 + s_n \left(a_{t-1}^{T,N}\right)^2 \right) \right]$$

2.4 Goods market equilibrium:

$$\begin{aligned}Y_t &= C_t + G_t + I_t + \frac{\gamma_l}{2} \left(L_t - L_{t-1}\right)^2 + \frac{\gamma_i}{2} \left(\frac{I_t}{K_{t-1}} - \delta \right)^2 K_{t-1} + \\ &\quad + (1-s_l)\, \frac{c}{2} P_{t-1}^{sh} \left((1-s_n) \left(a_{t-1}^{T,I}\right)^2 + s_n \left(a_{t-1}^{T,N}\right)^2 \right) - (1-s_l)\, \bar{w}.\end{aligned}$$

2.4.1 Exogenous processes:

$$\nu_t = (1-\rho_\nu)\, \nu^* + \rho_\nu \nu_{t-1} + \varepsilon_t^\nu$$

$$\log\left(A_t\right) = (1-\rho_a) \log\left(\bar{A}\right) + \rho \log\left(A_{t-1}\right) + \varepsilon_t^a$$

$$\log\left(G_t\right) = \left(1-\rho_g\right) \log\left(\bar{G}\right) + \rho \log\left(G_{t-1}\right) + \varepsilon_t^g$$

3 Relation between various returns:

The model has four Euler equations:

$$\lambda_t^l = \beta R_t E_t \lambda_{t+1}^l$$

$$E_t \frac{1}{C_{t+1}^{T,I}} a_t^{T,I} \left(c + \tau^{FTT}\right) = E_t \left[\frac{1}{C_{t+1}^{T,I}} \left(R_{t+1}^{sh} - R_t\right) \right]$$

$$E_t^N \frac{1}{C_{t+1}^{T,N}} a_t^{T,I} \left(c + \tau^{FTT}\right) = E_t^N \left[\frac{1}{C_{t+1}^{T,N}} \left(R_{t+1}^{sh} - R_t\right) \right]$$

and

$$Q_t = \beta E_t \left\{ \frac{\lambda_{t+1}^l}{\lambda_t^l} \left[(1-\tau^c)(1-\alpha) \frac{Y_{t+1}}{K_t} + \tau^c \delta + (1-\delta) Q_{t+1} \right] \right\}.$$

Rearranging and using $a_t^T = \frac{1-\theta}{1-s_l}$ as well as the expression for Q_t (without capital adjustment costs):

$$\frac{1}{R_t} = \beta E_t \frac{\lambda_{t+1}}{\lambda_t}$$

$$E_t R_{t+1}^{sh} = R_t + \left(c + \tau^{FTT}\right) \frac{1-\theta}{1-s_l} - s_n \nu_t$$

$$E_t R_{t+1}^k \equiv (1-\tau^c)(1-\alpha) \frac{Y_{t+1}}{K_t} + \tau^c \delta \simeq R_t (1+\mu_t) - (1-\delta)\left(1 + E_t \mu_{t+1}\right)$$

from which it is possible to establish an approximate relationship between the expected return on capital $E_t R_{t+1}^k$ and the expected return on shares $E_t R_{t+1}^{sh}$:

$$E_t R_{t+1}^k \simeq \left[E_t R_{t+1}^{sh} - \left(c + \tau^{FTT}\right) \frac{1-\theta}{1-s_l} + s_n \nu_t \right] (1+\mu_t) - (1-\delta)\left(1 + E_t \mu_{t+1}\right)$$

C. Additional considerations

Three important additional aspects in the current FTT debate, not covered by the previous model are (a) the effect of mobility of economic factors on the macroeconomic outcomes, (b) the incidence of the tax and (c) a possible redistribution effect across sectors. To consider these additional elements, Chisari, Estache and Nicodème (2011) develop a Computable General Equilibrium Model to assess the impact of imposing a VAT or tax on intermediate and final sales of the financial sector. The model is calibrated for Belgium in 2007. The choice of 2007 is guided by the desire to avoid the effects of the 2008 crisis while the choice of Belgium is guided by both the choice of a small open and developed economy and pure practicalities of data availability.

The financial sector is defined as financial intermediation services, except insurance and pension funding services as well as services auxiliary to financial services. It therefore excludes insurance and pension funding services. It represents 4.33% of total value-added in the model. The model contains 16 sectors (7 for goods and 9 for services) of the economy, a public sector and an external sector as well as details on their use of labour and capital inputs, as well as the input-output relationships between the sectors. Finally, the model includes information on the household consumption composition and can split consumers between 'riches' and the 'poor' (respectively the top and bottom two quartiles).

The model looks at the effects over 5 periods of introducing taxes and is defined as the differential between the simulation and the baseline dynamic and incremental scenario of a 3% GDP growth per year. Each year, prices are such that all markets are cleared, except the labour market to generate unemployment. In this framework, real wages increase by 1.5% in the first year[13]. Labour is however fully mobile across sectors while only 20% of capital input is mobile across domestic sectors (the remaining 80% is assumed to be sector-specific). Two scenarios of international mobility are proposed and compared: a closed-economy scenario for which capital is immobile internationally, and a scenario of mild capital international mobility under which 10% of the capital of households can be shifted abroad and avoid taxation.

Two main taxes are simulated: a 15% VAT on the financial sector and a 10% tax on the sales of the financial sector to other sectors and to households[14]. This latter scenario implies a cascading effect that proxies the qualitative effects of a Financial Transactions Tax.

In the closed-economy scenario, both taxes impact negatively on GDP and international trade. The negative effect of the FTT on GDP is twice as large as the one for VAT. Unemployment increases because of the tax in both cases during the first two periods before that the real wage adjusts. The fiscal result, expressed in welfare of the government, is 5 times larger with a FTT than with VAT. Interestingly, the VAT starts hitting the poor more than the riches in the short-run but this is inversed after 3 periods. The FTT is seen to be mildly progressive. Finally, almost all sectors of the economy suffer in about the same way

[13] Then the real wage adjusts to ensure full employment.
[14] In the paper, a simulation of a 10% sales tax to intermediate sales to other sectors only is also proposed.

when any of the tax is introduced but the negative effects are larger with a FTT than with VAT, because of the cascading effect. This shows that none of these taxes 'targets' the financial sector in practice.

The mild international mobility of capital scenario offers a good point of comparison. The effects of VAT on GDP are similar to the ones under the closed-economy scenario. For the FTT, even a mild international mobility dramatically amplifies the negative effects, which almost triple. For VAT, most of the results are qualitatively similar. Openness slightly decreases the regressive effect of the tax. For the FTT, the fiscal effects are negative in the short-run as capital escapes. The progressivity of the tax is by and large maintained. The impact on the sectors changes depending on their degree of openness. The financial sector is however hit hardly in both the short and long-run.

Reference: Chisari, Estache and Nicodème (2011), mimeo.

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ANNEX 16

EFFICIENCY ASPECTS

1. Concepts.

One can define tax efficiency in several ways.

A first concept of tax efficiency can be defined as a measure of the extent to which tax authorities avoid, when imposing a tax, disturbing the equilibrium - in terms of prices and quantities - that would have been achieved in the absence of taxation. It is difficult to think about any (positive) tax that could achieve full efficiency under this definition.

A second definition of tax efficiency is the extent to which taxes will not distort the equality between the marginal rate of substitution (MRS) and the marginal rate of transformation (MRT) that characterized (absent of tax) equilibriums on private goods markets[1].

In the absence of taxes, at equilibrium, the MRS between two private goods (A and B) equals the MRT between these two goods and both equal the relative prices of the goods P_B/P_A. A tax t on the good B will create a wedge between these two measures and we will have the following inequality[2]:

$$(1)\ MRS_{AB} = \frac{(1+t)P_B}{P_A} > \frac{P_B}{P_A}$$

A relatively simple way of measuring this distortion is to calculate the deadweight loss (also called Harberger triangle, excess burden or allocative inefficiency) created by the tax[3]. The

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[1] Equilibriums for pure Public Goods are characterized by equality between the marginal rate of transformation and the sum of the marginal rates of substitution.

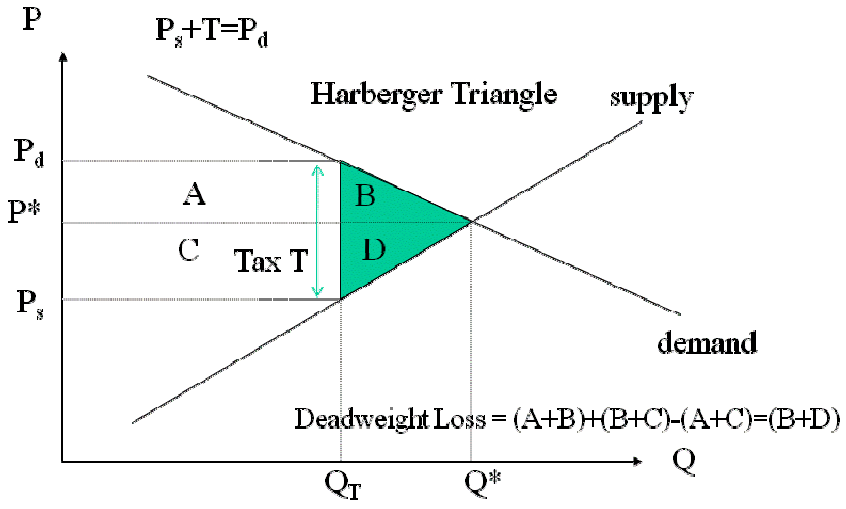
[2] Note that a lump-sum tax (i.e. a tax in the form of a fixed amount, independent of quantities consumed) would not distort this equality. The same could be true if the same tax rate would be applied to good A, in which case, the terms (1-t) would appear on both the numerator and the denominator, and would cancel out. This shows for example that differentiated tax rates on different goods distort the relative choices of consumers while applying the same uniform rate would not. However, this shall be true for any 'good' A and B that consumers shall choose. A classical example is the choice between working (i.e. choosing good A) and not working (i.e. choosing good B, leisure). In such case, it is difficult to think of a way of directly taxing leisure. In other words, an uniform tax rate on all possible goods (any physical good, service, labor, leisure, etc) could mimic the effects of a lump-sum tax and avoid distortions between the MRS and the MRT, but in practice, it is impossible to achieve.

[3] The concept was introduced by Harberger (1971). Several authors have refined it (e.g. Hausman, 1981; Willig, 1976). The consumer surplus – a concept introduced in 1844 by Jules Dupuit - is in general a good approximation of welfare (under specific technical conditions such as differentiability and monotony of the indirect utility function), even though the concepts of compensating variation and equivalent variation are more rigorous measures. It can be shown that the measure of consumer surplus lies between these two other measures. It shall also be stressed with Dixit and Weller (1976) that the consumer surplus is only an approximation for small changes and that if the revenue effect is large, one of the other two measures shall be used.

deadweight loss can be seen as a measure of the economic value of the loss in economic activity created by the tax (because e.g. there is less consumption or less working hours). In the figure hereunder, the equilibrium between demand and supply of a good is set at quantities Q* (horizontal axis) and price P* (vertical axis). At this equilibrium, the consumer enjoys a surplus equals to the difference between what she was willing to pay for each quantity (the demand curve) and what she actually pays P*, that is the area between the demand curve and the horizontal line set at P*. The producer also enjoys a surplus equals to the difference between the price P* she receives and the price at which she was willing to sell for each quantity (the supply curve), that is the area between the horizontal line set at P* and the supply curve.

If the government introduces a proportional tax t on the good (amounting to revenue per unit T), the impact of the tax will be split between the consumer and the supplier in proportions that depend on the slopes of demand and supply (i.e. their elasticities). The price for consumers will increase from P* to P_d and the price received by suppliers will decrease from P* to P_s (with the difference between P_d and P_s being the tax $T=tP_s$). Quantities exchanges will decrease from Q* to Q_T. The government will collect a tax T times the quantities exchanged, which corresponds to areas A+C on the graph. In practice, a tax burden A falls on the consumer and a tax burden B falls on the supplier. Because prices for consumers and suppliers have changed, so have the consumer's surplus and the producer's surplus. The consumer's surplus has decreased by the areas A+B and the producer's surplus has decreased by the areas C+D.

In sum, the losses for economic actors are (A+B) + (C+D) and the gains for the government is (A+C), possibly given back to economic actors. The balance is the triangle represented by (B+D), which is the deadweight loss of the tax.



If we assume linear supply and demand, the deadweight loss can be approximated by the formula (Rosen, 1992, p. 316):

$$(2)\ DWL = \frac{P^* Q^*}{2\left(\frac{1}{\varepsilon_D} + \frac{1}{\varepsilon_S}\right)} t^2$$

Where P* and Q* are the quantities without tax, t the marginal tax rate and ε_D and ε_S are respectively the price elasticity of demand and supply. Assuming an infinitely elastic supply, it can be simplified to

$$(3)\ DWL = \frac{P^* Q^* \varepsilon_D t^2}{2}$$

This term can also be expressed in terms of semi-elasticity by considering the relationship that the elasticity is the semi-elasticity times the average price.

Now, the price elasticity is not necessarily equals to the tax elasticity. The price elasticity can be defined as $\varepsilon_D = \frac{\frac{\Delta Q}{Q}}{\frac{\Delta P}{P}}$, while the tax semi-elasticity is $\varepsilon^{semi}{}_t = \frac{\frac{\Delta Q}{Q}}{\Delta t} = \frac{\frac{\Delta Q}{Q}}{t}$ when the starting tax rate is zero. Hence, it is easy to show that in this case $\varepsilon_D = \varepsilon^{semi}{}_t$.

A third definition of tax efficiency is the marginal cost of public funds (MCPF) introduced by Browning (1976), which is the loss incurred by society in raising additional revenues to finance government spending. It can be, for example, measured by the loss in GDP per unit of tax revenue raised (Dahlby, 2008).

A fourth definition of tax efficiency relates to the corrective (Pigouvian) aspects of taxation, that is to what extent they are efficient at correcting externalities, preventing undesired behaviors or incentivizing desired actions.

2. The Deadweight loss of the tax.

In this section, we look at the deadweight loss created by both the FAT and the FTT, applying the second formula above. The deadweight loss created by the FAT would be zero in case of an absence of relocation and elasticity effects. When more dramatic assumptions are assumed, the deadweight loss of the FAT in percentage of tax collected varies between 11.6% and 26.0% depending on the variant. This is to be compared with a ratio of about 5% for CIT. The deadweight loss of a FTT is much higher. While for spot equity and bonds transactions, it would be only about 5%, it jumps to 33% for spot FX and to 120% for derivative transactions. The level is also very large in absolute terms. For a broad-based FTT, the efficiency loss amounts to EUR 200 billion.

Tax	Scenario Elasticity	Estimated Revenue collected	Total DWL (EUR)	DWL in % tax collected

CIT	0.45[4]			5.3%[5]
FAT1	Combined semi-elasticity of -3.77[6]	EUR 24.6 billion	EUR 2.86 billion[7]	11.6 %
FAT2	Combined semi-elasticity of -6.85[8]	EUR 12.4 billion	EUR 3.24 billion[9]	26.0%
FAT3	Combined semi-elasticity of -6.85[10]	EUR 9.3 billion	EUR 2.12 billion[11]	22.7%
FTT – spot equity and bonds	Combined semi-elasticity of -200[12]	EUR 9.3 billion	EUR 0.52 billion[13]	5.56%
FTT – spot fx	Combined semi-elasticity of -800[14]	EUR 48.7 billion	EUR 16.22 billion[15]	33.3%
FTT – exchange traded derivatives	Combined semi-elasticity of -1,400[16]	EUR 70.2 billion	EUR 85.08 billion[17]	121.2%
FTT – Broad base total	Combined semi-elasticity of -1,302[18]	EUR 216.9 billion	EUR 202.24 billion[19]	93.2%

[4] Huizinga and Laeven (2008) estimate the elasticity of the corporate tax base to the rate at 0.45.

[5] In 2008, the average corporate tax rate is 23.6%. The DWL in % of revenue collected is computed via the formula $\varepsilon t / 2$. See Nicodeme (2008).

[6] The decrease profit due to relocation is estimated to be proportional to the decrease in total assets, that is the difference between columns (A) and (D) in table (9) of the main document, or 1.80%. This is the total decrease in the wage part of the FAT (elasticity of wages on remaining companies is estimated to be zero from Annex 8). Next, there is a 35% decrease in reported profit on the remaining 98.2% companies (semi-elasticity of -7 from Annex 8). That is 36.17% decrease in the profit part in total. All these changes for a 5 percentage point increase in the tax rate. For FAT1, the drop in the FAT tax base is (comparing tables (8) and (9)) 18.83%. Hence we have a semi-elasticity of -18.83/5 = -3.77.

[7] The tax base (P*Q*) is EUR 606.194 billion. The tax rate is 5%. The semi-elasticity is 3.77. Hence, the DWL is 606.194 x 3.77 x $(0.05)^2/2$.

[8] The drop is the tax base under the same assumptions as FAT1 is 34.25% (tables 8 and 9 of IA). Hence, we have a semi-elasticity of 34.25/5=6.85.

[9] The tax base (P*Q*) is EUR 378.034 billion. The tax rate is 5%. The semi-elasticity is 6.85. Hence, the DWL is 378.034 x 6.85 x $(0.05)^2/2$.

[10] The drop is the tax base under the same assumptions as FAT1 is 31.24% (Tables 8 and 9 of IA). Hence, we have a semi-elasticity of 31.25/5=6.25.

[11] The tax base (P*Q*) is EUR 271.396 billion. The tax rate is 5%. The semi-elasticity is 6.25. Hence, the DWL is 271.396 x 6.25 x $(0.05)^2/2$.

[12] -10% relocation divided by tax rate of 0.01%.

[13] The tax base (P*Q*) is EUR 20,670 billion. The tax rate is 0.05%. The semi-elasticity is 200. Hence, the DWL is 20,670*200*$(0.0005)^2/2$.

[14] -40% relocation divided by tax rate of 0.05%

[15] The tax base (P*Q*) is EUR 162,186 billion. The tax rate is 0.05%. The semi-elasticity is 800. Hence, the DWL is 162,186*800*$(0.0005)^2/2$.

[16] -70% relocation divided by tax rate of 0.05%.

[17] The tax base (P*Q*) is EUR 486,171 billion. The tax rate is 0.05%. The semi-elasticity is 1,400. Hence, the DWL is 486,171*1,400*$(0.0005)^2/2$.

Note: for the FTT, the chosen elasticity is 0 and the rate 0.01%. Relocation for equity and bonds is 10%, it is 40% for FX spots and 70% for derivatives instruments, and elasticity on remaining transactions is zero, which is the most optimistic scenario for the relocation.

3. The Marginal Cost of Public Funds.

An estimate of the loss in GDP per EUR of tax collected can be found in the various simulations in Annex 15. The marginal cost of public funds for the FAT is in the range of 0.6 to 2.4, which is lower than CIT (4.7) and much lower than a FTT which is in the range of 20.

Tax	GDP Loss (%)	Amount raised in % GDP	MCPF
CIT	-0.98	0.21	4.7
FAT1 – ST baseline	-0.12	0.18	0.6
FAT1 – LT baseline	-0.50	0.21	2.4
FAT1 – LT – high fixed L	-0.28	0.17	1.6
FAT1 and levy– LT	-0.53	0.28	1.9
FTT 0.01%	-0.17	0.01	17.0
FTT 0.1%	-1.76	0.08	22.0
FTT 0.2%	-3.43	0.16	21.4

4. Specific properties.

4.1. Cash-Flow taxation under a FAT.

As portrayed by Devereux and Sorensen (2006), cash-flow taxation possesses interesting efficiency characteristics. Cash-flow FAT could potentially be designed as Source-based cash-flow FAT, whose base would consist of domestic and foreign sales minus domestic and foreign purchases minus labour costs for the profit part, as Full destination-based cash-flow FAT whose base would consist of domestic sales minus cash and labour expenses for production of domestic sales for its profit part and of labour cost embedded in domestic sales for the labour part, or as VAT-type destination-based FAT whose base would be domestic sales minus domestic purchases and minus labour cost for the profit part. This last version would, as for VAT, zero-tax exports and tax imports instead.

All of these options share several interesting efficiency properties. First, as explained in Annex 10, cash-flow taxation falls on pure rents and exempts the normal return to capital. Since the Effective Marginal Tax Rate is zero, cash-flow taxation does not distort the domestic investment

[18] This is the decrease in total volume (in percentage) divided by the change in rates (in pp).

[19] The tax base (P*Q*) is EUR 1,242,657 billion. The tax rate is 0.05%. The semi-elasticity is 1,302. Hence, the DWL is $1{,}242{,}657*1{,}302*(0.0005)^2/2$.

decisions. Next, because the present value of the cash-flows from a marginal investment is equal to the initial investment outflow (thanks to immediate expensing), the timing is irrelevant and there is no tax advantage from deferral.

Cash-flow taxes also solve two distortions: they are neutral vis-à-vis organizational choice of companies and vis-à-vis the choice between debt versus equity financing. In that sense, they share the same property as an ACE or a CBIT (See Annex 18).

The full destination-based cash-flow FAT would in addition remove tax incentives for relocation as the tax on sales to domestic markets cannot be avoided by relocation. The VAT-type destination-based version of the FAT would achieve two other objectives: first, it would well mimic VAT and, second, it would eliminate transfer pricing problems since sales to foreign customers would not be included in the base.

All versions of FAT would still retain two specific problems of cash-flow taxes. The first one is the transition to the new system as the tax would fall on cash-flows from 'old' investments and could potentially create liquidity problems if no grandfathering is put in place. The second problem is the reaction to anticipated tax changes which can generate windfall profit or losses and disrupt the timing of investment. In addition, it is uncertain that cash-flow taxes would be necessarily recognized by third countries as eligible for foreign tax credits.

The source-based cash-flow version of the FAT would also retain the problems of potential profit-shifting and relocation unless intragroup transactions are included in the base. The full-destination-based cash-flow FAT would create the need to separate domestic cash-flows from foreign cash-flows. It would also create specific problems as to how to tax foreign companies serving the domestic market from abroad. This is because international tax systems only allow the taxation of firms with physical presence such as subsidiaries or permanent establishment. Finally, both the Full destination-based and the VAT-type destination-based cash-flow FAT would affect the equilibrium price in domestic and foreign markets. This is because exports would be zero-rated and imports would be taxed. Prices would need to adjust, which can create frictions under a fixed exchange rate system.

4.2. Coping with market price volatility and risk.

One element of the debate is whether any of the tax can decrease price volatility in markets. FAT3 could by design target risk. This requires however that higher profitability is correlated with risk. This is not necessarily the case. As seen in section 6.5.1, FAT1 has the best correlation of the three variants with individual contribution of banks to systemic risk (probably because both are linked to the size of the institution).

The analysis for the FTT is more complex to carry out at the level of individual firms because the FTT burden depends on trading activities of firms, for which no detailed data is available. The analysis has therefore to be done at the level of markets. Several studies have looked at the impact of transaction taxes on volatility (a review of this economic literature is provided in Hemmelgarn and Nicodème, 2011). The conclusions of this literature are:

(a) There is little evidence that the potential beneficial effects of a transaction tax outweigh the potential costs due to tax avoidance and unclear tax incidence.

(b) The evaluation of a financial transaction tax depends largely on the underlying assumptions about the functioning of the financial market and whether the potential market failure can be corrected using a transaction tax. In general, the proponents of the tax argue that the tax would reduce the number of noise traders and consequently technical trading. Furthermore, the tax would decrease price volatility and unproductive short-term speculation since investors would concentrate on the long-run return of projects. The opponents of the tax argue that it would increase transaction costs. This increase in transaction costs would reduce liquidity of markets and therefore market efficiency. It would decrease stock prices and increase the cost of capital companies leading to less investment. They also argue that such a tax would shift transactions away to other markets in countries which do not apply a financial transaction tax.

(c) The empirical finding mostly point to either no effect on price volatility or an increase in it due to a decreased number of transactions.

The empirical findings in Annex 15 show that a transaction tax would barely affect price volatility.

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ANNEX 17

INTEGRATION OF FAT WITH VAT

In so far as the FAT would be imposed on value added and it is argued that the FAT could serve to address the current VAT exemption of the financial sector, the question arises on the possibility to integrate the FAT with the VAT system in two different scenarios: (i) if the existing VAT treatment of financial services is kept; and (ii) if the VAT were to be applied to the financial sector. Both scenarios are analysed below.

1. FAT COMBINED WITH THE EXISTING VAT EXEMPTION.

The financial sector is subject to VAT on its inputs like most other industries. However, the exemption of financial services under Article 135 of the VAT Directive means that much of this VAT is non-recoverable so it is a real cost to the sector. The outcome is that the sector is taxed on its inputs.

If this cost is passed on to the customers of financial institutions in full and consistently, then when compared with full taxation business customers (B2B transactions) are overtaxed and private consumers (B2C) are undertaxed.

The impact of non-recoverable VAT is not transparent but a number of factors point to its being extremely uneven. The consequence is that similar activities or bundles of activities will not bear the same tax burden in different Member States. There are many reasons for this inconsistent taxation but the more important ones fall broadly under the following headings:

1.1. Differences in recovery rates

Although the VAT Directive requires that the rules on non-recoverability of VAT should be harmonised and deduction calculated similarly in all Member States and lead to similar results, this does not happen in practice. Differences in interpretation of EU law and concessional national practices (not always documented) are conducive to inconsistencies in recovery rates[1]. Furthermore, because there is no agreed common methodology for measuring the turnover of a financial institution for VAT purposes, the same accounting data can give different recovery rates in different Member States. This affects the amount of tax actually paid.

1.2. Option to tax

As allowed under Article 137.1 (a) of the VAT Directive, 6 Member States, each taking a different approach, allow the supplier of some financial services to opt to tax them. This

[1] For more information see report from IBFD on Survey on the recovery of input VAT in the financial sector (January 2007) available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/vat_insurance/vat_survey_financial.pdf

is likely to have a significant impact on the amount of non-recoverable VAT borne by the supplier. Some tax may be generated on supplies tofinal consumers. Where the option is applied only to B2B, it is possible that this part of the financial services provided is not burdened with VAT at all.

1.3. Differences in VAT rates

Some part of the difference in non-recoverable input VAT paid can be attributed to the possibility for Member States to apply a different level for their standard rate. These vary between 25% and 15%.

Moreover, it is not easy to observe and quantify either the total tax revenue collected by Member States attributable to non-recoverable input VAT on financial institutions or the level of such taxes borne by individual institutions.

The base line scenario for the VAT exemption therefore is both difficult to identify and not secure. There is little guarantee that comparable financial institutions will have comparable tax burdens, particularly if they are established in different Member States. If a FAT were to be integrated with VAT, this would have to be achieved in an environment where VAT is not a constant factor.

Were FAT to be computed on the same taxable base as VAT under an exemption model (*i.e.*, on inputs), some methodology would be needed to compensate for the fact that not all inputs bear VAT consistently and some not at all.

Were FAT to be computed on a "value added" defined per financial institution, the reality that institutions bear different levels of input VAT may be significant and would need to be taken into account.

In assessing the potential for integrating FAT with VAT, much would depend on what is the desired overall outcome. If it is primarily to increase the tax contribution from the sector, then the uneven impact of the VAT exemption should not be a limitation and a FAT could be levied in an independent manner. If however what is being sought is to tax financial activities (under both VAT and FAT) in a manner which is both consistent across the sector (and aims at creating a level playing field) and also increases the overall tax take, then the unevenness in the tax burden under the existing VAT model would be problematic and would need to be tackled.

Whilst it is to be hoped that the current negotiations in the Council on the modernisation of the VAT exemption[2] will in time lead to a more consistent VAT treatment, this would

[2] COM (2007) 747 Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services and COM (2007) 746 Proposal for a COUNCIL REGULATION laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services.

not be enough to eliminate the variations in the actual burden of non-recoverable VAT between Member States.

A more consistent outcome might be achieved if a FAT/VAT integrated system was based on using outputs for VAT purposes as a common taxable base (in other words, if financial services were fully subject to VAT). The usual reason given for VAT exemption for financial services is the difficulty with computing the tax base (for outputs). This however may not be a totally valid response and some consideration is merited as to whether this apparent obstacle can be overcome in practice. However, a full VAT application is likely to result in higher prices of some financial services for final consumers (B2C).

2. FAT COMBINED WITH A FULL APPLICATION OF VAT.

Several models have been advanced which would allow for the charging of VAT on financial services. Although they are often perceived as suffering from deficiencies which render them problematic, they also point to taxation as being technically feasible even if the solution lacks elegance. If the case for exempting VAT from financial services is essentially a negative one, predicated on deficiencies in the alternatives of taxation, some thought should be given to whether the complexity, uncertainty and inconsistency inherent in exemption really produce a better outcome.

2.1. Tax calculation account method (TCA).

This was developed by E & Y for the Commission and, based on cash flows, seeks to measure the margin from financial intermediation services on a transactional basis consistent with invoice credit VAT. The Commission's assessment was that its complexity rendered it unsuitable for legislation. Nevertheless, the TCA method confirmed that it was technically feasible to apply VAT to financial services.

2.2. Modified reverse charge.

Howell Zee of the IMF has devised a model for taxation based on a transaction-by-transaction franking system which is generally seen as compatible with the normal VAT system. It has however never been tested in practice.

2.3. European Banking Federation (2009).

A report commissioned by the EBF from E & Y concluded that a simplified margin based system could be implemented but for practical and competitive reasons, a zero rate should be applied to B2B transactions.

Although this report was envisaged in the context of the more extensive option to tax proposed by the Commission in 2007, the underlying accounting-based concepts could equally be applied in a more general taxation scheme.

2.4. Ad-hoc methodologies in various Member States.

Those Member States which allow the option for taxation on margin based transactions have adopted rules or practices for determining the taxable base for these transactions.

There is no common methodology and in many cases the computation of the taxable base is ad-hoc and even crude. In some instances, gross interest is accepted as a basis for taxing interest on loans although this is conceptually flawed and leads to exaggerated recovery rates (which may in practice be the intention).

None of these are perfect solutions but would seem to confirm that it is technically possible to apply VAT (and in the case of the option to tax, this actually happens in practice), albeit that significant further development work would seem to be needed. Such a perspective seems to underlie the conclusions adopted by EcoFin in November 2010 where the Commission was asked to pursue further work on the identification of the taxable base in collaboration with the Member States and to explore solutions which allow for a departure from the existing VAT exemption[3].

Ending the VAT exemption means that VAT on financial services would function as VAT normally does – as a tax on final consumption by consumers. Normally VAT would not fall as a charge on business that will be able to recover input tax.

Integrating FAT with VAT under a full VAT taxation system would start with some advantages (notably a consistent tax base) but also raise some questions. The amount of tax collected (as a function of the consumption by households of financial services) gives a clear base-line but questions would then arise as to how extensive FAT should be. Should it be an additional levy, parallel in scope but in addition to VAT or should it aim at a wider coverage?

Under full taxation, VAT would generally be recoverable for business clients. In so far as FAT is conceived as a non-recoverable tax, the impact of an integrated VAT/FAT would be mixed. As a rule, FAT would be borne directly by the financial institution whereas VAT would fall on the consumers of the financial services which it delivers.

3. CONCLUSION

The extent that some existing taxes on the financial sector (other than non-recoverable VAT) in certain Member States are linked to VAT, at least partially, opens up a possibility of a linkage between VAT and FAT on a more consistent basis. For instance, the *taxe sur les salaires* in France is payable in inverse proportion to the extent to which a financial institutions activities are subject to VAT. If for example, 20% of its outputs are subject to VAT then 80% in value (100% minus 20%) of salaries are subject to this tax. As mentioned elsewhere in this document, defining the financial institutions that would become subject to FAT by reference, amongst other criteria, to some other VAT concept (such as the recovery pro-rata) would also be a possibility.

This takes account of the reality that the activities of most financial institutions for VAT purposes are a mixture of taxable and exempt. For FAT, a linkage of this nature to VAT might be considered as a first step in establishing a taxable base. The rate to be applied could then be fixed in the context of broader policy objectives.

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[3] Beyond mentioning the EcoFin conclusions and the obligation to continue work on the taxable base, this note does not consider the wider social and political context of removing the VAT exemption for financial services.

If it is considered desirable to integrate VAT and FAT (for whatever reason), this might be seen as a reasonable degree of linkage in the current circumstances. Were the VAT exemption ever to be replaced at some point in the future by full taxation, the concept would obviously have to be reconsidered. In the meantime however, some particular consideration would have to be given to how to apply FAT for the very limited number of financial institutions whose turnover is fully subject to VAT under the existing option to tax.

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Proposal for a Council Directive

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ANNEX 18

THE DEBT-EQUITY BIAS - CONSEQUENCES AND SOLUTIONS

1. INTRODUCTION: THE DEBT-EQUITY BIAS AND THE FINANCIAL CRISIS.

The tax deductibility of interest payments in most corporate income tax systems coupled with no such measure for equity financing creates at least two types of tax distortions (These problems are well-known and have been analysed in European Commission, 2010, chapter 4).

First, it may lead to too-high leverage. In the context of the previous crisis, the debt-equity distortions did not create the financial crisis but it leaned in the wrong direction and may have aggravated it (Shaviro, 2011; Shackelford, Shaviro and Slemrod, 2011; IMF, 2010; Hemmelgarn and Nicodeme, 2009). This could lead to liquidity constraints, especially in times when banks tend to restrict their credit supply. A well-designed tax base that reduces the leverage distortion could make companies less vulnerable to a short-term reduction in credit available on the capital market. There is indeed empirical evidence that the leverage of companies is indeed influenced by taxes. The debt-bias may also have lead to the issuing of hybrid instruments that blend characteristics of debt and equity, such as convertible bonds. These instruments qualify as debt and therefore allow for the deduction of interest paid but have equity-like characteristics. The instruments also tend to reduce the transparency and accountability of corporate financing policies. However, there are so far no empirical studies on the magnitude of these effects. Second, this distortion in financing exacerbates opportunities to shift and decrease reported profit via debt-shifting or the use of hybrid instruments.

Correcting the debt bias may therefore lead to beneficial effects. It is peculiar, in the present context of seeking corrective taxes to curb risk that the current corporate tax system actually contains tax distortions that do the opposite and provide incentives to take up too much debt.

The corporate tax bias interacts with several other non-tax determinants of corporate structure and with taxes at the personal and cross-border level. The next sections review these two aspects in turn. Next, we will analyze the extent and size of these distortions as well as their impact on welfare. We will stress the specific context of the financial sector. The following section will review policy options to correct this bias and will also stress some of the possible consequences. Several recent works have been carried out on this topic and we draw mainly on them. In particular, de Mooij (2011) and Graham (2011) offer a comprehensive discussion of the issue, while Shaviro (2011) studies the bias in the context of the financial crisis.

2. THE DETERMINANTS OF CORPORATE STRUCTURE.

The standard Modigliani-Miller (1958) theorem states that in the absence of agency and bankruptcy costs, of asymmetric information, of taxes, and under the assumption of market efficiency, a firm is indifferent between various sources of financing (either issuing stocks or

issuing debt)[1]. In this environment, the value of an unleveraged firm is equal to the value of a leveraged firm: $V_L=V_U$.

In most corporate tax systems, however, debt-financing is favored via the tax-deductibility of interest payments. When this aspect is taken into account, the value of the leverage firm is equal to the value of the unleveraged firm, augmented by the tax shield value of debt. This tax shield equals the amount of debt times the corporate tax rate: $V_L = V_U + tD$. Hence, a company can maximize its value by being financed 100% by debt.

There are however other theoretical reasons why debt and equity-financing may be distorted. First, highly-leveraged firms are more vulnerable and face bankruptcy costs (sometimes also called cost of financial distress) which increase with the level of debt. In such case, the optimal debt level is set to the point where the marginal benefit of an additional unit of debt (here the tax rate t) equals its marginal cost (here the marginal bankruptcy cost). Second, so-called agency costs may lead to an increased use of debt. Agency costs reflect conflicts of interest between shareholders and, on the one hand, managers and, on the other hand, bondholders. In the first case, asymmetry of information on the situation of the firm gives incentives to shareholders to promote debt financing as this restricts the Free Cash Flow available in the company.[2] This is because the Free Cash Flow usually derives from rent-generating activities and provides managers with funds to invest in wasteful investments. It also creates incentives for managers to make the firm growth beyond its optimal size, notably because their remuneration may be linked to the size of sales. Managers could promise to give back this Free Cash Flow to shareholders via higher future dividends but the dividend policy can easily be reversed. Therefore, by substituting debt for equity, managers are bound to pay out the cash flows because bondholders (who can be shareholders) have the right to take the firm to court. This can be a determinant of capital structure of companies (Jensen, 1986). In the second case, shareholders may have an incentive to convince managers to finance by debt because they can then shift part of the bankruptcy cost to bondholders. Third, debt issuance (alike dividend policy) has signaling effects. The direction of this effect is nevertheless disputed both theoretically and empirically. On the one hand, it can indicate that the firm is confident about its repayment capacity (Ross, 1977). On the other hand, it can indicate that the firm lacks internal resources and is dependent to debt markets, which can lead to adverse selection problems in the form of a lemons market for debt. This led to the pecking order theory of Myers and Majluf (1984) and Myers (1984) that firms will favor internal equity over debt and debt over external equity (because as new shares shall not be issued if a firm is undervalued, the issuance of new shares is interpreted as a sign that the company is overvalued). In that case, there would be too little borrowing in general but also an asymmetry with too little borrowing from good firms and too much from bad firms. Stiglitz and Weiss (1981) provide a model of credit rationing based on this adverse selection. However, de Mooij (2011) points to two potential problems. First, the same rationing could affect equity markets as shown by de Meza and Webb (1987) and tax discriminating in favor of debt would then increase the distortions. Second, the tax distortion favors mostly those firms that have access to credit and are highly leveraged. Graham and Leary (2011) show indeed that firms vary widely in their use

[1] In addition, its dividend policy shall not matter.

[2] Free cash flow is cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital (Jensen, 1986)

of debt. Taking data from Compustat annual files from 1974 through 2009, they show that highly-leveraged companies (quintiles 4 and 5 compared to quintiles 1 and 2) are "*significantly larger, older, have more tangible assets, lower market-to-book ratios, less volatile earnings, higher marginal tax rates and less R&D intensive*". This is particularly true for firms with long maturity of debt. The relationship is however non-linear since *very* highly-leveraged firms (quintile 5) are smaller, younger, have higher market-to-book ratios and more R&D-intensive than those that are highly-leverage (quintile 4). At any rate, it shows that the across-the-board deductibility of interest can create distortions across types of companies.

3. IS THERE A RATIONALE FOR DISCRIMINATING?

Some of the aspects review here above may offer theoretical economic rationales for using the tax system to discriminate between debt and equity. As pointed by De Mooij (2011), however, the withering borderline between debt and equity instruments alters the relevance of these theories. No strong externality would call either for a bias in favor of debt. The financial crisis stressed rather the opposite.

In the majority of tax systems, the more so with the use of sophisticated instruments, the distinction between debt and equity is subject to the application of several criteria such as the degree of variability of the claim, the control of the size of the payment by the management, the priority put on cash-flows, the type of maturity (fixed or variable / infinite), etc. Devereux and Gerritsen (2010) show that there are no objective legal reasons to distinguish between both sources of financing. On the contrary, the rise in administrative complexity would rather call for a similar tax treatment. The distinction could possibly originate in an artificial distinction made by the traditional view that dividends were merely seen as the remuneration of capital while interest payments constitute a business cost.

As reported by EEAG (2011, chapter 5), the issue of high leverage in the banking sector has been subject to research. Some of the arguments to justify this high debt point to the role of debt to discipline managers (the agency cost discussed here above), the increased funding costs because equity is more risky, and a possible credit rationing. Admati et al. (2010) and Hellwig (2010) find that these fears are unlikely to materialize and that in such case they would internalize the externalities imposed on taxpayers and creditors. In addition, the pronounced use of sophisticated products by financial institutions allows them to take advantage of differences of treatment between taxation and regulatory purposes. This is the case for example of contingent convertible capital (also known as 'CoCo' or "contingent core Tier-1 capital"). This is a form of debt (and treated as such for tax purposes) that will convert into shares once the financial institutions capital requirement falls under a reference level. Some countries may count them as capital, leading to a double-benefit for the financial institution and an incentive to use such instruments.

4. INTERACTION WITH OTHER TAXES.

One possible rationale for favoring debt over equity via corporate taxation could lie in the analysis of taxation at shareholder and bondholder levels. Personal income taxes indeed discriminates as interest received is often taxed in full at personal income tax rates while capital

gains and dividends are often taxed at lower separate final withholding tax rates (Gordon, 2011)[3]. There is also evidence that the level of debt is negatively related to the personal tax penalty (Graham, 1999). According to Graham (2011), the empirical evidence implies that the PIT disadvantage is between 1/3 and ½ of the CIT advantage, so that overall the tax advantage of debt remains.

There is finally evidence that the tax advantage of debt fuels profit shifting activities. For example, Huizinga, Leaven and Nicodeme (2008) review economic literature that consider the debt finance of multinationals with either parent companies or subsidiaries in the United States[4], Germany[5], Canada[6] and the EU[7]. This literature is consistent with tax minimization objectives of firms using their financial structure and interest and income flows across borders. Taking data from 32 European countries between 1994 and 2003, they find that a 10% increase in the tax rate increases leverage by 1.8%. For multinationals with two equal-size establishments in two countries, a 10% increase in the tax rate in one country leads to an increase in leverage of the company located in that country by 2.4% and a decrease in leverage in the affiliated foreign company by 0.6%, indicating debt-shifting.

In a related fashion, De Mooij (2011) looks at the effect of taxes on gross bank profitability and finds semi-elasticities of between -6 and -8.5, which is very large compared to non-financial firms and which makes him conclude that banks seem to engage in more tax avoidance than non-financial firms do.

5. EXTENT AND SIZE OF THE DISTORTIONS.

Because of the tax deductibility, most tax systems in Europe actually provide a subsidy when financing via debt. In other words, they bear a negative effective marginal tax rate (see graph hereunder). This indicates that projects that would not be profitable in the absence of taxation become profitable thanks to the subsidy. This creates a large distortion in investment.

[3] Nevertheless, in many Member States, interest income from banks from special savings or investment accounts is exempt.

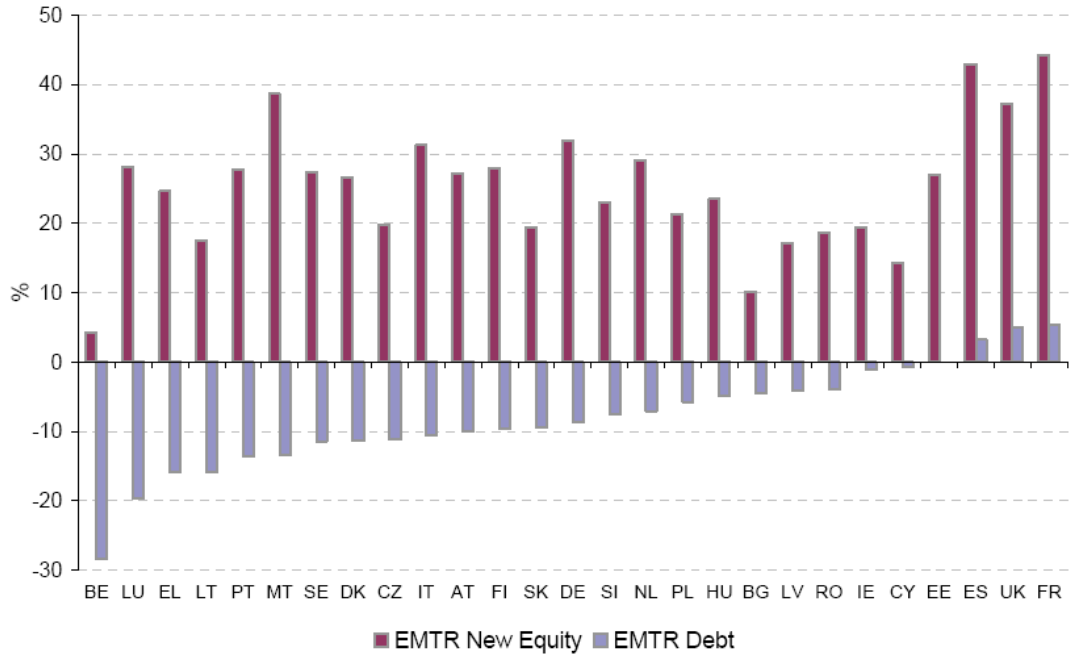
[4] Hines and Hubbard (1990), Collins and Shackelford (1992), Froot and Hines (1992), Grubert (1998), Altshuler and Grubert (2003), Newberry and Dhaliwal (2001), Desai, Foley and Hines (2004), Mills and Newberry (2004).

[5] Ramb and Weichenrieder (2004) and Mintz and Weichenrieder (2005).

[6] Jog and Tang (2001)

[7] Moore and Ruane (2005).

Graph 4.1: **Effective Marginal Tax Rate (EMTR) of debt vs. new equity financed investment in EU27 countries**



Source: Source: European Commission (2010e).

Source: European Commission (2010)

Reacting to this benefit, the economic literature provides ample evidence that of a positive correlation between the level on leverage and the level of corporate taxation. It goes beyond the aim of this section to review the existing literature exhaustively. Such a review is proposed by De Mooij (2011) and uses 267 tax elasticities found in 19 studies to perform a meta-analysis. The mean tax elasticity across studies is 0.65 (the median stands at 0.51) but with a large standard deviation of 0.57. Interestingly, 78% of the regressions have results that are significantly different from zero. The results also indicate that the response increases over time and that the relationship may not be linear. Finally, internal debt seems more responsive than external debt to taxation and short-term debt is more responsive than long-term debt. Translated into their impact of debt to asset ratio, the consensus elasticity from De Mooij (2011) lie at 0.28 for broad measures of financial leverage[8] and 0.17 for narrow measures.

De Mooij (2011) also uses a sample of 14,377 banks from 82 countries across Europe, Asia and the Americas between 2001 and 2009. He finds that on average, the leverage ratio of banks is 88.1%, compared to a ratio of between 40 and 60% for non-financial firms. This is strong indication that the leverage issue is more acute for banks. Next, he studies the impact of taxes on

[8] i.e. including non-debt liabilities (reserves, accounts payable to creditors, insurance and non-interest bearing liabilities).

the capital structure of banks and finds effects of corporate taxation that are either similar or slightly lower than for non-financial firms. Such similarity is confirmed by Gropp (2011). Given the regulatory capital constraints imposed on financial institutions, this effect appears significant.

This large effect is not without consequences. Indeed, Adrian and Brunnermeier (2010) define systemic risk as CoVaR, the value at risk (VaR) of the financial system conditional on institutions being under distress. With this measure, the contribution of an individual institution to systemic risk is the difference between CoVaR conditional on the institution being under distress and the CoVaR in the median state of the institution. They show that leverage (alongside relative size and maturity mismatch) exerts an effect on systemic risk. In their regressions, they find that "*the coefficient of -0.164 for the leverage forecast at the two-year horizon implies that an increase in leverage (say, from 15 to 16) of an institution is associated with an increase in systemic risk of 16.4 basis points of quarterly asset returns at the 5% systemic risk level. For an institution that has $1 trillion of total market-valued assets, this translates into $164 billion of systemic risk contribution*."(Adrian and Brunnermeier, 2010, page 23).

6. IMPACT OF WELFARE.

Because of the tax bias, debt financing creates a welfare cost. This welfare cost has been estimated by Weichenrieder and Klautke (2008) at between 0.08% and 0.23% of GDP, while Gordon (2011) estimates it at about 0.25% of GDP. As rightly pointed by De Mooij (2011), these estimates assume an average elasticity that applies to a representative firm and fails to take into account the heterogeneity of responses and hence the additional welfare costs due to misallocations. They also fail to include the larger welfare costs of the negative externalities of using debt such as the systemic risk, the probability of default and the social costs of business cycle fluctuations. Finally, they do not take into account the distortions created by debt-shifting activities and the misallocation due to international tax arbitrage as well as the administrative and compliance costs (De Mooij, 2011).

7. POLICY OPTIONS TO CORRECT THE DEBT BIAS.

Several policy options are on the table to correct the tax bias towards debt financing. Some of them are already used in practice, intentionally or not. For example, reducing corporate tax rates decreases the value of the tax shield for debt. Another option is to implement thin capitalization rules. The favourable tax treatment of debt offers opportunities for corporate groups to pursue debt-shifting strategies to minimize their total tax burden. To counter these avoidance strategies, countries have increasingly adopted thin capitalization rules. Thin capitalization rules are formal restrictions on the deductibility of interest paid to by corporations that have excessive debt compared to their equity or assets. They vary widely in terms of their definitions and scope but their use has developed dramatically since the 1990s. They may lead to the disallowance of (excess) interest deductibility or, in some cases, to requalification as dividends. Several papers have found them effective to curb leverage (see e.g. Buettner et al., 2006). Shaviro (2011) also proposes worldwide interest allocation rules for multinationals but notes the technical difficulties of this. He also mentions the possibility of applying full dividend exemption or imputation. We

have seen however that this may not suffice to correct the debt bias. In addition, it is only a corrective measure which does not target the core of the problem at the corporate level.

In principle, two alternative corporate tax systems exist that might eliminate the distortion between debt and equity by treating both sources of finance in the same way: an Allowance for Corporate Equity (ACE) or a Comprehensive Business Income Tax (CBIT)[9]. The ACE would grant a deduction for return on equity (new or total equity) as it is the case for interest paid and would hence reduce or abolish the tax advantage of debt. The CBIT system would achieve the same result by denying interest deductibility at the corporate income tax. ACE and CBIT have been discussed extensively in the economic literature (see e.g. De Mooij and Devereux, 2009, 2011).

If designed in a revenue-neutral way, the CBIT would increase the tax base and allow decreasing the tax rate. Many recent policies have advocated in favor base-broadening-cum-rate-cut policies. This reasoning is largely based on the fact that the efficiency losses measured by deadweight losses are proportional to the square of the tax rate. It is also based on the idea that profit-shifting, investment and location of companies are somewhat linked to corporate tax rates. In such case, one shall advocate for a CBIT. Several aspects are however missing in this analysis. First, the application of CBIT by other countries erodes the competitive benefit of a lower tax rate, assuming that other countries will reduce their own. Second, while there are indications that profit-shifting activities are mostly driven by the statutory tax rates, investment and location could be driven by effective (respectively marginal and average) tax rates, which include other elements of the tax system. Next, the analysis differs if there are rents. This is because only the tax rate will affect the rents. Increasing the base and decreasing the rent shift therefore the tax burden from rents towards normal return. If rents are immobile (e.g. they are location-specific), this would create macroeconomic losses. If rents are mobile (e.g. they are company-specific), a CBIT could attract those rent-making companies and create macroeconomic benefits. A CBIT is not without problems. As pointed by Shaviro (2011), CBIT carries some difficulties such as how to treat pre-existing debt and how to treat shareholder capital gains upon selling equity as exemption could create opportunities for tax avoidance. In addition, suppressing the interest deductibility can impact on hedging. It would also increase the cost of capital and, all else equal, decrease firms values (Graham, 2011). The effect on bankruptcy is also unclear. On the one hand, reducing leverage reduces the probability of defaulting but on the other hand, the increase in the cost of capital would increase the probability of defaulting. In the precise context of the financial sector taxation, De Mooij (2011) points to a possible undertaxation under a CBIT. This is because under a CBIT, interest paid is not deductible but interest received would not be taxed. The (untaxed) difference is exactly the margins of banks on the deposits-loans activity. Borrowers would face the full tax burden, including the bank's margin. It would in addition create a distortion between untaxed domestic banks and taxed foreign ones.

If designed in a revenue-neutral way, an ACE would achieve the opposite result than a CBIT by decreasing the tax base and increasing the rate. The discussion hereabove applies mutatis mutandis and again depends on the type of rents. An ACE does not need to be designed in a revenue-neutral manner. For example, the Belgian reform towards an ACE left the corporate tax

[9] Initially proposed by the US Treasury in 1992.

rate unchanged and was a way instead to replace specific regimes affecting the tax base. In such case, De Mooij (2011) calculates that the fiscal cost is about 15% of CIT revenues or about 0.5% on average and when increased investment and employment effects are factored in. The cost also depends on whether the ACE applies to new investment only or to the total stock of capital, in which case an ACE can represent a windfall. A non-neutral ACE reform also carries important political economy aspects as it can be perceived by the public opinion as a gift to companies. An ACE also offers some important additional advantages. First, by allowing companies to deduct their cost of capital, it does not tax the normal return to capital and taxes rents only. It is therefore non-distortive for investment. It therefore bears similar properties as a cash-flow tax. An interesting variant of the ACE is the Allowance for Corporate Capital which allow for the deductibility of a notional risk-free return to capital irrespective of whether it is in the form of equity or debt. It corresponds to the idea of a Business Enterprise Income Tax (BEIT).[10]

Despite the advantages of financing neutrality, ACE or CBIT reforms can be found only in very few Member States.[11] The economic analysis shows however that moving to such systems could potentially bring substantial benefits in terms of reducing leverage, systemic risk and profit-shifting. In this context, an ACE seems to carry the more interesting features.

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[10] Boadway and Bruce (1984), Kleinbard (2007, 2011). Both ACE and CBIT systems are appealing due to their efficiency properties with regard to the financing decisions of companies. In a way, a ACC corresponds to a combination of the two systems, i.e. a system that imposes limitations in the deductibility of interest but allows for a partial deduction in the return on equity, to respect revenue-neutrality. A combined reform of a partial ACE and a partial CBIT mitigates the discrimination between debt and equity in both directions. At the same time, the implications for corporate tax revenue are offsetting. Therefore, one can design a reform package of a partial ACE and partial CBIT that is revenue-neutral for the government and which is still neutral with respect to the financial structures of companies. First, this would preserve financing neutrality. Secondly, it would reduce possible negative effects of each of the pure ACE or CBIT systems. De Mooij and Devereux (2009, 2011) look at the design of corporate tax bases with respect to financing neutrality using ACE and CBIT systems as well as a combination of the two. The investigation of the tax distortions of investment financing and the possible measures against these distortions have been analyzed in a simulation model. The authors present simulations of different reform options, as well as comparing the implementation of ACE and CBIT as pure systems with a combination of both. These different types of reforms are investigated both for the case of individual implementation by each EU country - with the others sticking to their current tax systems - and for the case of a simultaneous implementation by all Member States. Under the assumptions of the model, it is shown that combining the two ACE/CBIT systems leads to the same neutrality in investment financing as each single reform but also improves welfare, both in the case of unilateral reforms and of EU-wide reforms.

[11] Belgium implemented an ACE system; Italy had ACE elements in its tax system but removed them after a short period. Germany limited interested deductibility which is a move towards CBIT. Italy has also limited the deductibility of interests thus moving towards a CBIT. Estonia has a CBIT system which does not allow interest deduction. Austria had implemented an ACE system from 2000 until 2003. It was replaced by a favorable tax treatment for retained earnings from 2004 until 2009 for individuals. As from 2010, an indirect instrument for encouraging the accumulation of equity of businesses of individuals (a tax free profit amount) was introduced. Finally, Latvia introduced an ACE as from 1 January 2009, in the case where a company is not distributing dividends partially or fully, taxable income is reduced by the amount of interest, which the company would have to pay for an equal loan.

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