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NOTE

from:	General Secretariat of the Council
to:	European Council
Subject:	Preparation for the European Council - Levies and taxes on financial institutions = Report to the European Council

Delegations will find in the Annex the Council (ECOFIN) report to the European Council on the state of play on financial levies and taxes, as agreed by Council (ECOFIN) on 19 October 2010.

Council (ECOFIN) report to the European Council on the state of play on financial levies and taxes

1. The crisis in global financial markets has been putting the stability of the financial systems around the world to the test. In addition to actions by central banks, unprecedented and extraordinary measures were taken by governments to support the financial sector in 2008 and 2009 by means of capital injections, guarantees and asset relief measures, with the resulting increased fiscal burden on the tax payer and the risks to the sustainability of public finances witnessed since the beginning of 2010.

2. The crisis has shown that that better structures are needed for prudential supervision and crisis management, requiring more effective tools to prevent crisis and resolve financial institutions, in particular the Systemically Important Financial Institutions (SIFIs), in an orderly manner. The agreement by both the European Parliament and Council on the supervisory package is an important step forward. This should be complemented with further improvements in the EU framework for crisis management and resolution to ensure that authorities have the instruments and the means to resolve troubled banks in an effective and timely way or to liquidate them in an orderly manner, also on a cross-border basis.

3. In view of better anticipating and defraying the cost of a possible crisis, there is broad agreement at the international level that the financial sector should make a 'fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or fund resolution and that a range of policy options can be pursued, including levies and taxes. Although not mutually exclusive, their impact on the banking sector should be considered together with other measures currently in the process of being introduced, in particular the new capital and liquidity requirements as well as the measures aiming at an adequate funding of Deposit Guarantee Schemes, in view of not overburdening the EU financial sector and safeguarding the flow of credit to the economy. Synergies with the Deposit Guarantee Schemes (DGS) should also be fully explored while respecting the core function of the DGS.

4. In this respect, the June European Council agreed that "*Member States should introduce systems of levies and taxes on financial institutions to ensure fair burden-sharing and to set incentives to contain systemic risk. Such levies or taxes should be part of a credible resolution framework. Further work is urgently required on their main features and issues of level playing field and cumulative impacts of various regulatory measures should be carefully assessed. The European Council invites the Council and the Commission to take this work forward and report back in October 2010*."

I. Financial levies

5. The Council has carried forward the work on the main features of financial levies[1] and it is clear that while there is a growing consensus on the base and scope for such a levy, this is not the case at this stage on the objective or on the allocation of proceeds (to the general budget or fund) of such a levy.

6. Meanwhile, an increasing number of Member States[2] are moving ahead by introducing country specific systems of levies for which the parameters (base, rate and scope) differ considerably notwithstanding the growing consensus mentioned above, reflecting different objectives, specific domestic circumstances as well as fiscal sovereignty. This divergence in parameters has resulted in double taxation issues and risks creating competitive distortions[3] and relocation of activities within the EU financial sector.

7. In respect of levies, a two-step approach should be pursued. First, problems of double charging and coordination should be addressed as a matter of urgency. Second, the debate on the more structural aspects of the levy linked to the setting up of crisis resolution structures should be continued once the Commission has presented its proposal in respect of an EU framework for crisis management[4]. <u>In the short-term</u>, the focus should be on:

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[1] EFC AHWG report on levies on financial institutions, Ares (2010) 629166 of 27 September 2010.

[2] Seven Member States have systems in place at present (see table in annex) and another three are contemplating the introduction of such a levy.

[3] An additional assessment may need to be carried out in order to assess the compatibility of measures adopted by Member States with the EU treaty provisions and in particular State aid rules.

[4] The Commission is expected to come forward with its Communication on proposals for an enhanced EU regulatory framework for crisis management in October and with legislative proposals in spring 2011.

- Ensuring a minimum level of coordination among the different schemes in place by including an appropriate level of flexibility in national measures from the outset to adjust to changing circumstances as appropriate. Subject to national discretion, this could be achieved by including a "rendez-vous clause" in national measures. Such a clause would also allow for reviewing the national levy in function of a European-wide solution once agreement is reached on such a solution, and possibly, also on a transition period to do so.
- Maintaining a level playing field across Member States. This involves both avoiding double charging between Member States and safeguarding as much as possible equal treatment across national and EU banking markets in respect of branches and subsidiaries, in full respect of the Treaty. Elimination of double charging between Member States should preferably be achieved at EU level and require agreement on the scope of application of the national levies. Although bilateral arrangements might provide an alternative in the short term, they are not optimal from a level playing field and transparency point of view and may cause a huge additional administrative burden for both national administrations and companies. At the same time, they would still require an agreement on the relevant principles in order to ensure coherence across the EU.

8. In the medium term, the levy should be part of a credible crisis resolution framework and more harmonised crisis resolution structures, tools and powers should be considered, based on legislative proposals by the Commission and common operational features across Member States.

Next steps

9. The Council has invited the EFC to look into the possibilities for EU-wide and bilateral solutions to ensure the necessary coordination between the different national schemes currently in place in view of avoiding double charging[5] of EU bank entities and will report back to the European Council in December.

10. The Council looks forward to the forthcoming Commission proposals for a more harmonised EU crisis management framework in view of handling future crises and will carefully consider these proposals at it next meeting in view of reporting back on them to the December Ecofin Council.

[5] In the context of the current debate on levies, double charging covers both the incidence of tax and fee at national level.

II. Financial sector taxation

11. The interest in financial sector taxation has resurfaced as the enormous budgetary implications of the most recent economic and financial crisis have become clear. Different options are on the table and we have had a first discussion based on a preliminary technical analysis by the Commission. In this context we considered both the Financial Transaction Tax (FTT) and the Financial Activity tax (FAT).

12. The Financial Transaction Tax (FTT) might contribute to ensuring that the financial sector makes a fair and substantial contribution to public finances provided it is properly calibrated and applied globally. However, reaching agreement in this respect at the global level might be difficult and, considering the global nature of financial markets, applying such a tax at the EU level alone may result in significant distortion of competition and relocation of financial activity within the global financial system, resulting in reduced fiscal revenues. The EU should therefore very carefully consider its options in this respect and, in order to carry this debate forward at the EU and international level, a comprehensive analysis should be carried out by tax experts on what the conditions would be for implementing such a tax.

13. Financial Activity Tax (FAT) type taxes already exist in some Member States in a broad variety in order to allow a specific taxation of the financial sector, which is largely VAT-exempt. More recently, it has gained further attention as it has been proposed by the IMF in its report to the G20 and is considered by the IMF and some Member States as a viable option to make the financial sector contribute[6].

Next steps

14. The Council takes note of the Commission communication on the taxation of the financial sector of 7 October and of the intention of the Taxation Policy Group (TPG) to examine different options. A Council High Level Working Party could examine the options and prepare conclusions, where appropriate.

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[6] The introduction of a FAT in Germany would encounter legal problems at constitutional level.

Annex 1: Existing and currently envisaged national systems of levies on financial institutions

– State of play October 2010-

		Adoption state of play	Date of first payment	Scope	Base	Rate	Destination of proceeds	Revenue raising objective
FUND based solutions								
1	**Germany**	Draft bill		• All domestic Banks • Collected on a single entity basis (not group level)	• **LIABILITIES** excluding capital and deposits **and** • **Derivatives** (nominal value)	**Progressive FEE for liabilities** • 0.02 percent for liabilities under €10bn • 0.03 percent over €10bn; and • 0.04 percent above €100bn **Flat FEE for derivatives** • 0.00015 percent **Capped at 15% of credit institution's annual profit (after tax)**	**FUND** to be used for the orderly resolution of systemically important banks	€1 bn per year
2	**Denmark**	1 October 2010	**ex-post financing**	• banks	•		**Winding up fund**	Drawing rights Initial capital of approximately €430 million.

BUDGET based solutions								
3	**Sweden**	• Introduced in 2008 • New proposals expected on the possible design of a risk-differentiated fee in a combined system with the deposit guarantee scheme.	2009	• banks • other credit institutions	• **LIABILITIES** excluding equity capital and some junior debt securities. Participating FIs issuing debt within the guarantee scheme can deduct an average of their guaranteed liabilities from the basis on which the stability fee is calculated	**Flat FEE** 0.036% per year, levied on certain parts of liabilities. Only 50% of the fee charged for 2009 and 2010.	Stability **FUND, Proceeds allocated to an account in the BUDGET** managed by the Swedish National Debt Office as the resolution authority.	Stability fund targeted to reach 2.5% of GDP over the next 15 years.

		Adoption state of play	Date of first payment	Scope	Base	Rate	Destination of proceeds	Revenue raising objective
4	**Belgium**	Introduced in 2009	2010	• banks, • stock-broking firms • life insurance companies	• Deposit base for banks and member stock-broking firms. • Total eligible life insurance products for insurance companies.	**ENTRY FEE:** to be paid by banks and member stock-broking firms: 10 bps applied on the deposit base payable in two equal tranches, one in 2010 and one in 2011 **ANNUAL LEVY** (first payment in 2011): • 15 bps of the deposit base of the preceding year for banks and stock-broking firms; • 15 basis points of total eligible life insurance products for insurance companies	Special FUND proceeds included in the **BUDGET**	€ 1.43 bn over a three-year period (2010-2012)
5	**France**	To be introduced in budget law this autumn	2011	Limited to banks • at consolidated level for French banking groups • at local level for subsidiary of foreign groups, • **NO** taxation of foreign branches established in France	• Risk weighted assets (**RWA**)	0.25 percent of the capital requirements (based on RWA)	**GENERAL BUDGET** (with accounting monitoring of proceeds)	€500 mn - €1 bn per year

		Adoption state of play	Date of first payment	Scope	Base	Rate	Destination of proceeds	Revenue raising objective
6	**UK**	Consultation on legal aspects and technical details ongoing; final proposal due in the fall	2011	Banks with aggregate liabilities above £20 bn • at consolidated level for UK banking groups • liabilities of UK banks in non-banking groups • liabilities of the aggregated subsidiary and branch balance sheets of foreign banks and banking groups operating in the UK	**TOTAL LIABILITIES** (both short and long term) excluding: • tier 1 capital • insured retail deposits • repos secured on sovereign debt • policy holder liabilities of retail insurance businesses within banking groups	In 2011: 0.04% After 2011: 0.07% Reduced rate for longer-maturity wholesale funding (> 1 year remaining to maturity) to be set at 0.02% rising to 0.035% after 2011.	**GENERAL BUDGET**	£2 bn annually, but only £1.5 bn for 2011

7	**Hungary** (flexibility to change certain aspects of the levy for 2011-2012, not for 2010)	Voted in the parliament	30 September 2010	• Credit institutions, • Insurers • Other financial organizations (financial enterprises, stock exchange service providers, investment firms, investment fund management firms and venture capital fund management companies	Subject to the specific features of services provided: • For credit institutions: the modified balance sheet total • For Insurers: corrected premium income • For Other financial organizations: financial enterprises: interest rate earnings + fee and commission earnings investment firms, and venture capital fund management companies: corrected net revenue, investment fund management firms: the assets managed	Subject to the specific features of services provided: For credit institutions: 0.15 percent (up to 50 billion HUF of tax base) 0.5 percent (for the part of the tax base exceeding 50 billion HUF) For Insurers: 6.2 percent For Other financial organizations: ○ financial enterprises: 6.5 percent • investment firms, and venture capital fund management companies: 5.6 percent • investment fund management firms: 0.028 percent	General **BUDGET** Main objective is to bring the country's budget deficit under control.	€700 mn

Annex 2: Example of double taxation risks

Geographic scope of the levy –current situation						
	Domestically				***Abroad***	
Country	Parent	Foreign subsidiaries	Foreign branches (non-EU)	Foreign branches (EU)	Parent's subsidiaries	Parent's branches
Sweden	X	X				X
Germany	X	X	X			X
France	X	X			X	X
UK	X	X	X	X	X	X

As a consequence some entities may face more than one levy. For example, Swedish, French and German branches in the UK will be levied (taxed) twice, while a Swedish subsidiary in Poland would not be levied at all today. The current risks of double taxation may be illustrated by a simple example with a French parent bank with a subsidiary in Sweden, which in its turn has a branch in the UK. In such a case the levies (taxes) will be taken out as follows:

French parent bank	Subsidiary in Sweden	Branch in the UK
Levy to: France	Levy to France and Sweden	Levy to: UK and Sweden (and France)