Statement to the attention of the Finance Committee of the Bundesrat .

Prof.mr.Lieven Denys, 30 November 2011.

Blueprint for a multilateral and multi-jurisdictional Treaty on the Financial Transaction Tax.Some elements for comparison with the EU draft Directive on the FTT.

1. It should be clear that the recommendation to implement now a Financial Transaction Tax to finance development and environment is based on thorough research on the feasibility of such a financing mechanism. Leading Countries and authoritative International Institutions and NGO's have called for action. The European Commission has even tabled its concrete proposal.

2. A major reservation always put forward is that the initiative should aim at a universal introduction because the mobility of capital flow may allow delocalisation and economic distortions. To cope with these concerns a strong international coordination is thought to be required. So it was felt that there is a missing step in the process.

3. In the follow up of last years Expert Committee report on financial levies to the Leading Group for the Finance of Development we were commissioned together with an advisory team of four economic and legal top experts to prepare an international instrument: a blueprint to enable discussion, decision and implementation of an international agreement to introduce national FTT's based on a harmonised design, coordinated at the international level to secure a solid internationally agreed system of tax collection at the level of central financial market structures.

4. The four experts we could count on are prof. Avinash Persaud from London (also present today), Dr Rodney Smith from Canada, Dr Bruno Jetin from Paris and prof.dr. Michel Tison from Ghent. We were assisted by a PhD researcher, Marie Lamensch of the Institute of European Studies.

5. One of the first recommendations of the Blueprint is that the G 20 is a most appropriate to initiate the process of implementation,

   - precisely, because it is preferable to act at the level of globally integrated financial markets and to avoid economic distortions and not to hinder free movement of capital,

   - and because tax sovereignty of States is eroded when they have to act with inefficient solitary tax mechanisms without combined efforts in a world of global capital markets.

6. The Treaty proposes an international system based on national tax sovereignty and offers a harmonised tax approach.

   It could follow up on a G20 declaration (call) in favour of innovative finance mechanisms either

   - first option: as an EU initiative ,possibly through a limited group of Member States that engage in an enhanced cooperation, supplemented with EU agreements with other States, or
   - second option: as a multilateral treaty among a number of States, to which some EU members would participate or
   - third option: as a multilateral treaty, to which economic regions such as the EU could adhere as a whole.

7. On **the substance** of the proposal for a treaty on the FTT and the design of the tax , I refer to the Blueprint which includes the text and also an explanatory and summary memorandum published on the website of the Leading Group for the Finance of Development: **http://www.leadinggroup.org/rubrique20.html.**

8. This statement aims to introduce some elements of **the framework** of the draft treaty and to highlight some of its basic features by reference and comparison to the proposal tabled by the EU commission. This proposal has, seen from the perspectives of financing development and the requiring international coverage, some worrying lacunae. The blueprint for a draft treaty was finished more than a week before the commission tabled its proposal and happens to have dealt with some of these lacunae. But let there be no doubt : the highest respect goes to the work of the services of the EU Commission have performed , not in the least as this appears from the accompanying and published research , which is excellent and most impressive.

   Both proposals are conceptually largely convergent as to the design of the tax and in there essential characteristics: both envisage a large tax base and scope, and minimal tax rates.

9. Obviously the treaty uses notions and concepts that are more universal whereas the EU Directive refers more to EU – regulations. The divergences between both illustrate that political arbitrage at the international level will be required, given that the context and the legal framework are to a certain extent fundamentally different.

10. I will limit my introduction to **<u>four important differences</u>** which give me the possibility to highlight some basic features of the draft treaty:

    1. the international legal framework,

    2. the different options as to the scope and design of the FFT (who pays on what transactions and financial assets),

    3. the tax collection mechanisms (how will the tax be raised in practice),

    4. the tax evasion

It be repeated that these comments are only complementary suggestions to bring the proposals closer.

First issue: the international legal framework and the common purpose.

11. **The draft treaty** is a flexible international agreement among Sovereign States to coordinate and harmonize internationally their FTT with the common goal to finance development.

The treaty facilitates a gradual introduction in successive phases of a national tax by individual, independent and autonomous states. It allows individual accession in a flexible way to a multi-lateral system, and it allows individual withdrawal.

The harmonized tax system and tax collection is solidly coordinated on a multi-lateral basis to avoid non-taxation and delocalisation but even so to avoid multiple taxation.

The treaty has a purpose of an international dimension: sharing tax revenues for the financing of development and environment. Part of the revenue would be put together in a Common Development Fund to realise common multi-laterally agreed development goals. The draft treaty leaves open for negotiation which part of the tax is transmitted. What is not transferred is largely meant to be used for development.

The gradual and democratic introduction of the FTT system and the democratic control of the funds allow for re-negotiation after evaluation at regular intervals. It allows progressive and negotiated co-funding, maintaining a democratic marge de manoeuvre at national level to directly or collaterally finance development.

The Governance of the Common Development Fund allows an organised integration of the voices of the other stakeholders of Development such as the developing countries and civil society.

12. **The EU proposal** on the other hand is a far less flexible instrument, requiring unanimity of 27 Member States that could however authorise a group of at least nine States to proceed (the so-called enhanced cooperation). Revision requires a similar decision process, with the exclusive right of initiative of the EU Commission.

This requirement is even reinforced by a provision in the proposal that excludes all parallel or complementary FTT's (only an increase of rates would be possible).

The EU proposal is for the financing of the EU-budget, the so-called own resources, and aims at taxing the financial institutions so that they participate to the costs of the financial crises.

The tax would also serve the own economic goal of avoiding further fragmentation of the EU-internal market of financial services.

The EU proposal clearly is at odd with the democratic political principle of no taxation without representation and implies a political power shift at the level of the EU budgetary policy-making.

Moreover the EU proposal provides for a delegation of important regulatory power in taxation (for instance to define and enlarge the scope of the tax, to determine which businesses have important financial activities and to prescribe new national measure to counteract tax evasion).

On the second issue I shall be brief and refer to the published[1] summary memorandum of the draft treaty: I can limit my few remarks to **the difference in scope and design.**

13. **The draft treaty** proposes an FTT on financial markets as comprehensive as possible. In a catch-and approach it includes all counterparties of the financial sector (investors, businesses and financial institutions) whether resident or not, but also all financial intermediaries and the financial market infrastructures, including the post-trading service providers; it includes all type of transactions and all financial instruments and products as long as there is a territorial link with the taxing jurisdictions on account of one of these other factors on the relevant market (one of the parties, or one of the intermediaries, or the nationality/territoriality of an asset or product).

14. **The EU proposal** also aims at a large base but restricts the scope to the transactions that involve European based financial institutions active in the trading (excluding post – trading intermediation) excluding private investors, general business enterprises and thus also their transactions abroad, as well as non resident financial institutions that trade in European financial instruments wholly abroad.

Moreover the EU proposal would not tax currency transactions (on the spot market) other than currency derivatives. These restrictions of the scope of application entail the serious risk of delocalisation of trade outside the EU and artificial arrangements with European assets and derivatives on underlying European market elements.

Excluding private investors (retail sector) and general non-financial business may substantially reduce administrative simplicity and the effectiveness of tax control. It is at odd with the equal treatment principle in taxation.

The draft treaty on the other hand provides for more refined options to exclude small and medium type of trade.

The third issue related to the mechanics of the tax collection.

15. **The EU proposal** prescribes the taxation of financial institutions on accrual basis, meaning tax is due when the contract is concluded in the trading phase and not when the payment is made in the post – trading phase of settlement. The tax base is to be determined at arm's length basis (normal market values). Derivatives are taxed on the notional values and not on the money that actually changes hands.

This approach inevitably leads to practical taxation problems in interpretation and compliance, requiring costly tax control; it puts a burden on the shoulder of the financial institution which is often but intermediaries.

16. **The draft treaty** on the other hand opts for taxation in post – trading at the point of settlement on the basis of effective payments; the financial infrastructure or payment institution is to withhold the tax.

This delivery versus payment or payment versus payment system through the settlement institutions suits the electronic environment of the financial markets and the regulatory trend for central clearing and settlement.

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[1] **http://www.leadinggroup.org/rubrique20.html.**

Two practical tax compliance devices are offered in the treaty: a one stop scheme allowing financial intermediaries that intervene in cross border markets involving several States, to comply with FFT for all transactions, through one State of choice (that will redistribute the revenues to other States). This device, as many other techniques in the draft treaty, is borrowed from the VAT scheme for electronic business (from which the financial markets are exempt and thus under-taxed).

The second original compliance device is the treaty proposal for an electronic tag that is attributed upon payment of the tax and that liberalises all actors in the chain of a transaction, and eliminates the risk of double taxation.

17. Because of the limited scope of this introduction I will not elaborate on the equilibrated techniques in the treaty to avoid double and multiple taxation and to allocate the taxing and collecting right of the States. I refer you to the relevant text of the treaty that opts for taxation revenue for the State with the closest territorial link.

The EU proposal logically attributes the taxing right to the State of residence of the financial institutions.

The last **issue** I promised to signal relates to the **measures to deal with tax evasion:**

18. **The EU proposal** leaves that to the Member States, which is a high risk in a financial environment where the mobility of capital is highly intensive. Moreover it is an invitation for harmful tax competition between EU States.

19. **The draft treaty** provides for a comprehensive set of robust anti avoidance measures tested at the international level, such as the non-enforceability of untaxed transactions as in the UK stamp duty system, the revers change mechanism of the VAT, the solidary tax liability contamination of all intermediaries in the chain of transactions as in the money laundering legislations, the group taxations at consolidated or regional level, the concepts of ultimate beneficiaries and of substituted transactions of equivalent effect and other robust measures.

The last remark on that issue I should make is pointing to the incorporation and application of the recently adopted European Directive techniques on the cross border recovery of tax claims which allow any tax claim of a EU Member State, including thus the FTT, to be recovered in any of the 27 Member States, in the hands of all institutions that are jointly liable.

Also the EU proposal points to this possibility.

The proposed treaty also takes advantage of the G20 successfully induced wave of tax cooperation and transparency conventions that emerged since 2008 global financial crisis, and in particular the impressive outcome of the OECD Global Forum on transparency and exchange of information for tax purposes, piercing the veil of bank secrecy.

20. Let me conclude with a word on the **Global Solidarity Dilemma** where the overall benefits of globalisation are in sharp contrast to the vast shortfall in finance required to meet international (global) developmental and environmental challenges and commitments.

Indeed the proposed multilateral and multi – jurisdictional tax mechanism, that need not to be universal, appears to resolve the global solidarity dilemma. Although the financial sector, which benefits from the globalization of economic activity, would pay a significant contribution, the burden of payment would also ripple out from settlement institutions across global financial ánd economic activity. Revenue would not be raised in an asymmetrical manner by the States with global financial centres, but would be spread across global economic activity, not only financial, to pay for global public goods.

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