

**ABI response to the DG  
Taxation and Customs  
Union consultation paper on  
financial sector taxation**

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**POSITION PAPER**

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## **ABI response to the DG Taxation and Customs Union consultation paper “Taxation of the Financial Sector”**

The Italian Banking Association (ABI) welcomes the opportunity to comment the DG Taxation and Customs Union consultation paper “Taxation of the Financial Sector”.

ABI considers misleading the Commission’s views that additional taxes could indirectly and in addition to regulation contribute to the goal of improving the stability of the financial sector by dissuading it from carrying out certain risky activities and be a revenue source to repay those governments which provided substantial support during the crisis. This is particularly true in the light of the current lack of common agreed definitions, even on the meaning of the word “financial sector”.

Moreover, ABI does not agree that because most financial services are exempt from value added taxation, additional taxes should be envisaged to impose a fairer and more substantial contribution to government finances.

Therefore, ABI invites the Commission Services to refrain introducing additional financial sector taxation in the European Union.

### **1. The financial sector taxation as a means to contribute to the goal of improving the stability**

It is important to recall that not all actors in the financial sector received support from governments during the crisis. This is true only for some financial actors in some Member States. Notwithstanding the responsibilities in the crisis, which appear to be too simplistic put exclusively on the banking sector, a differentiation of this sort is essential.

Therefore, the argument that banks should now make “a fair and substantial contribution” to public finances cannot be equally applied to all financial actors in all Member States. Justifying further taxation of the financial sector on this basis alone would be hardly acceptable. In this respect, we would like to underline that the G20 has not approved at the international level the idea of further taxation of the financial sector as of yet, in recognition of the need for a country-specific approach.

In addition, it is quite challenging to assess just how much taxpayers stand to gain or lose from banks' rescues. Recent evidence suggests that in the case of the United Kingdom for example, where governments made profit from the sale of the shares acquired in banks such as RBS. At the same time, it should be underlined that most financial institutions have already paid back their respective governments for the support received during the crisis.

## **2. The financial sector taxation as a means to dissuading from carrying out certain risky activities**

ABI believes that a levy on banks, either asset or liability-based, would not be effective in tackling excessive risk-taking or leverage.

A crude, non-risk based levy either asset or liabilities-based does not appear as an effective instrument to discourage excessive risk-taking. In other words, if the aim of taxation is to reduce risk, then a balance sheet-based levy would largely be ineffective.

These objectives should be met through regulatory reforms by strengthening, for example, rules on prudential requirements. We refer to the reforms currently implemented by the Basel Committee in the area of capital and liquidity requirements, prudential regulation as well as rules on the trading book. Similarly, we would like to recall the Commission's ongoing work on crisis management and resolution, which might also have significant consequences on the liabilities side of the balance sheet and hence impact on banks' funding models.

Experience from Member States that recently introduced a bank levy suggests that a balance-sheet based tax is not necessarily conducive to stronger risk-management. If anything, it can severely impact on banks' capability to lend, hence on the financing to the real economy.

In addition, the introduction of a levy might lead to relocation of business and investments outside the EU.

## **3. The financial sector taxation as a means to impose a fairer and more substantial contribution to government finances**

ABI disagrees on the point that banks are low-taxed; the VAT exemption of financial services delivered by a financial institution is associated in the VAT legislation with no right – or limited right - to deduct input VAT. This means that financial institutions cannot fully deduct the VAT incurred on own expenses, which therefore is a pure cost.

The amount of this “hidden VAT cost” may be significant as outsourced services and intra-group transactions suffer a cascading effect of the tax.

In this context, it is worth to recall that the EU banking sector provides the 20 per cent of the EU government finances while participating to just 5 per cent of the GDP.

In certain Member States, such contribution is even higher; in Italy, for example, the financial sector is over taxed because:

- In addition to the Corporate Income Tax (IRES), Italian banks are subjected to a Regional Tax on Productive Activities (IRAP), which in turn is set roughly 1 per cent higher than the IRAP applied to the other productive sectors
- 4% of interest expenses is non deductible for IRES and IRAP purposes
- Credit losses are not allowed for IRAP purposes
- Dividends on trading are fully taxed
- VAT paid is not refundable because of VAT exemption of financial services rendered (input VAT is therefore a cost for the sector).

As a result, there are EU countries where banks are taxed at 15-20 per cent, while in Italy they are taxed at a nominal rate more than 30 per cent. The effective rate, in 2008, crossed the 40 per cent.

#### **4. The financial sector taxation and the cumulative effect with other regulatory requirements, crisis management and bank levies**

ABI invites the Commission to take into account the cumulative impact of additional regulation currently proposed or recently implemented onto the financial sector.

Due to the recent significant changes in the area of capital requirements, and in the light of the potential additional provisions on deposit guarantee schemes, regulation on systemically important financial institutions and crisis resolution, we urge the Commission to fully assess the impact of all of the proposed measures on the ability of the financial sector to properly function.

The competitive implications of new taxes on the EU financial sector, with regard to the necessary level playing field between the banking sector and the non-banking sector, the competitiveness of EU banks with non-EU banks and the ability of the banking industry to continue to meet the financial needs of the real economy cannot therefore be ignored.

Considering the possible magnitude of the economic impact of additional taxes on the financial sector, ABI urges the Commission to complete a holistic impact assessment and to publish the findings with full transparency before presenting fiscal initiatives.

Finally, we would like to take the opportunity of this public consultation to highlight the lack of a clear and comprehensive understanding of the purpose and prospect of introducing a financial sector tax at EU level.

The Commission's Communications of October 2010 and the Consultation Paper of February 2011 do not adequately clarify the objectives which the EU fiscal initiative would primarily aim to address.

This means first to clarify how the Commission would intend to use the revenue generated by additional taxation.

There seems to be a paradox between the requirement for banks to rebuild and strengthen their capital base, lend more and pay more taxes at the same time.

However, if the objective is to avoid future crises and excessive levels of leverage in financial institutions, then the proposal would be misguided. We maintains that such objectives can only be met through fundamental regulatory reforms, such as more stringent capital requirements, compulsory use of central counterparties for certain derivatives, a stronger crisis prevention framework, credible resolution systems for financial institutions and enhanced supervision.

## **5. The rationale of the Financial Transactions Tax (FTT)**

ABI agrees that a tax on financial transactions (FTT) consistently applied at global level would probably contribute to achieving the objectives to reduce the scope for price volatility and excessive risk-taking.

Indeed, from a macroeconomic perspective, risk-taking and price volatility could only be reduced through a FTT on a global level. The financial sector operates on a global basis with capital able to move freely and easily with trading carried out electronically across many jurisdictions. Consequently a real risk of the imposition of an EU wide FTT is that the tax base would be immediately eroded as a consequence of the migration of transactions outside the scope of the rules.

Therefore, in order to maintain the level playing field and a competitive advantage for the EU financial sector, a FTT should be introduced at global level only. Even if the relocation of financial institutions would not happen overnight, the effect of additional taxes and levies is likely to accelerate the trend for new investments to be made outside of the EU, thereby damaging its economy.

Taxes at the EU level only would increase the trend for relocation of activities and investments outside the Single Market and are thus to be discouraged.

## **6. The rationale of the Financial Activities Tax (FAT)**

ABI rejects the Commission's proposal to introducing a Financial Activities Tax (FAT) at EU level because, as highlighted above in paragraph 3, the Italian banking sector is already subject to an additional taxation on productive activities which broadly mirrors the Additional method FAT (so called FAT 1) proposed in the Commission's Communication of October 2010 and the Consultation Paper of February 2011.

On the other hand, the introduction of an EU-defined FAT would require further adjustments on the accounting side, in order to overcome the current differences across Member States. It is worth to note, in fact, that those banking sectors which apply the IFRS at individual level are obliged to adopt the fair value criteria to assess their profits.

This being said, the introduction of a FAT, i.e. a new tax based on cash flows and designed to balance the "under-taxation" due to the VAT exemption for financial services, is in any case not a fair way to compensate for the VAT exemption.

On the contrary, the Commission should assess the merits of designing such a new tax within the VAT framework, so as to ensure an administratively easier approach for the sector.

The Commission issued in 2007 a proposed Directive to reform the VAT treatment of financial services based on three pillars, including the proposal for an option to tax financial services for business customers.

The European banking sector has been very supportive of this work, since the current VAT Directive is out of date and needs to be modernised so as to enable European banks to compete on an equal footing with other actors in the financial sector and with non-European banks. So far, Member States have not reached agreement on this proposal which is still pending.

This would permit, moreover, to design a common approach to double tax relief. It should notably make sure that any differences in costs for banks having a branch structure *versus* a subsidiary structure are eliminated.

## **7. The need of common rules for a genuine single market**

The idea to introduce new forms of taxation, to be calculated using rules harmonised at EU level, would not duly take into account the fragmented background of the national tax systems, both in terms of fiscal pressure and interaction with the national tax bases.

In other words, there is a risk that the new EU taxes, in the absence of a common background, would impact on the EU banking sector emphasising the differences across jurisdictions and therefore weakening the level playing field within the EU single market.

Therefore, ABI strongly supports the Commission's proposal to introduce a Common Consolidated Corporate Tax Base (CCCTB) which would permit to eliminating differences in taxation which produce competitive distortions within the Single Market while preserving the national sovereignty in setting the tax rate.