

Edited by Otto Marres and Dennis Weber

Taxing the Financial Sector

Financial Taxes,
Bank Levies and More

IBFD

Taxing the Financial Sector: Financial Taxes, Bank Levies and More

Why this book?

(New) tax levies on the financial sector have been an ongoing subject of interest since the financial crisis of the past years. In *Taxing the Financial Sector: Financial Taxes, Bank Levies and More*, various ways of taxing the financial sector are discussed. The many discussions in the book provide practical guidelines for all those working in the financial sector.

Twelve prominent practitioners and academics give their views on the tax levies on the financial sector from a legal and an economic perspective. Subjects discussed are:

- The EU financial transaction tax Proposal
- Capita selecta of the financial transaction tax
- Overview of existing national taxation of the financial sector
- Experiences from the financial transaction tax in Colombia
- Bank levies in the United Kingdom
- Financial activities tax in Italy
- Introduction of a bank tax in the Netherlands
- The financial transaction tax and the TFEU freedoms
- Taxing financial transactions and State aid rules
- Financial transaction tax and VAT
- The financial transaction tax versus the financial activities tax
- Financial sector taxation and the ongoing financial crisis

Title:	Taxing the Financial Sector
Subtitle:	Financial Taxes, Bank Levies and More
Editor(s):	Dennis Weber, Otto Marres
Date of publication:	June 2012
ISBN:	978-90-8722-141-6
Type of publication:	Print Book
Number of pages:	226
Terms:	Shipping fees apply. Shipping information is available on our website
Price:	EUR 105 / USD 135 (VAT excl.)

Order information

To order the book, please visit www.ibfd.org/IBFD-Products/shop. You can purchase a copy of the book by means of your credit card, or on the basis of an invoice. Our books encompass a wide variety of topics, and are available in one or more of the following formats:

- IBFD Print books
- IBFD eBooks – downloadable on a variety of electronic devices
- IBFD Online books – accessible online through the IBFD Tax Research Platform



IBFD, Your Portal to Cross-Border Tax Expertise

Table of contents

Preface	v
Chapter 1: The FTT Proposal – An Overview of Legal Issues Arising	1
<i>by Oskar Henkow</i>	
1.1. Introduction	1
1.2. The tax subjects – Financial institutions	3
1.2.1. Regulated financial institutions	3
1.2.2. Extension to other undertakings engaged in financial activities	4
1.3. The tax object – Financial transactions	6
1.3.1. Introduction	6
1.3.2. Financial instruments	7
1.3.3. Sale and purchase of financial instruments	9
1.3.4. Transfers between entities of a group	11
1.3.5. Conclusion and modification of derivative contracts	12
1.4. Territorial scope	13
1.4.1. Introduction	13
1.4.2. Residence for FTT purposes	14
1.4.3. The “economic substance” of a financial transaction	17
1.5. The taxable event (when the tax is chargeable)	18
1.6. The taxable amount and tax rates	19
1.7. The payment and administration of the tax	21
1.8. Final remarks	23
Chapter 2: <i>Capita Selecta</i> of the Financial Transaction Tax Proposed under EU Council Directive 2011/594	25
<i>by Martine J. Peters</i>	
2.1. Introduction	25
2.2. Goals of the Directive	25
2.2.1. Correction of market behaviour	25
2.2.2. Cascading effect	27
2.2.2.1. Clearing and settlement activities	27
2.2.2.2. Financial intermediaries	28
2.2.2.3. Audit and procurement	28
2.3. Tax technical difficulties	29
2.3.1. Taxable event	29

Table of Contents

2.3.2.	Taxable basis	30
2.3.2.1.	Listed derivatives	30
2.3.2.2.	Structured products	31
2.3.2.3.	Repo and stock lending	31
2.3.4.	ISDA documentation	32
2.4.	Withholding and remittance	33
2.5.	Conclusion	34

Chapter 3: Overview of Existing National Taxation of the Financial Sector 35

by Barry Larking

3.1.	Introduction	35
3.2.	Variations on a theme	36
3.3.	Focus on three financial sector taxes	37
3.3.1.	Financial Transaction Tax (FTT)	37
3.3.2.	Financial Activities Tax (FAT)	38
3.3.3.	Bank levies	39
3.4.	Country experience	39
3.4.1.	Financial transaction taxes	40
3.4.2.	The plot	41
3.4.3.	Unravelling the plot	41
3.4.4.	Lessons learned	42
3.4.5.	Connecting factors	45
3.4.6.	Exemptions and rates	46
3.5.	Financial activities tax	46
3.6.	Bank levies	47
3.7.	Conclusion	50

Chapter 4: If It Moves, Tax It: The Financial Transactions Tax (FTT) in Colombia 53

by Catalina Hoyos Jiménez

4.1.	Introduction	53
4.2.	Main features of the tax: If it moves, tax it	55
4.2.1.	Background	55
4.2.2.	The regulation today	59
4.2.2.1.	Tax events	59
4.2.2.2.	Tax exemptions	60
4.2.2.3.	Tax base and tax rate	63
4.2.2.4.	Taxpayers	63
4.2.2.5.	Tax returns	63

4.2.2.6.	Deductibility of FTT from income tax	64
4.3.	Collateral effects of the tax	64
4.3.1.	Tax burden	64
4.3.2.	“Unbanking” processes vs informal economy, tax evasion and money laundering	66
4.3.3.	Higher costs of the financial system and reduction in financial intermediation	67
4.3.4.	Tax arbitrages and competition among financial institutions	68
4.3.5.	The tax is bad in general: It is sand in the wheels of the whole economy	68
4.4.	Reconciling FTT with the fundamental rules of taxation	69
4.5.	The future of the tax	70
 Chapter 5: Taxing the Financial Sector: Bank Levies in the United Kingdom		 71
<i>by Liesl Fichardt</i>		
5.1.	Introduction	71
5.2.	The legislation	72
5.3.	Overview of the scope, the charge and the tax base	73
5.4.	The charge, the chargeable period and collection	75
5.5.	The tax base	75
5.6.	Chargeable equity and liabilities and excluded categories	76
5.7.	The steps for determining the levy: The seven key steps	77
5.8.	Anti-avoidance	82
5.9.	Double taxation	83
5.10.	The rates	84
5.11.	Conclusion	84
 Chapter 6: Financial Activities Tax (FAT) in Italy		 87
<i>by Paolo Ludovici and Mario Tenore</i>		
6.1.	Introduction	87
6.2.	The notions of “financial sector” and “executives”	89
6.3.	Remunerations subject to the Bonus Tax	92
6.4.	International aspects of the Bonus Tax	93

Table of Contents

2.3.2.	Taxable basis	30
2.3.2.1.	Listed derivatives	30
2.3.2.2.	Structured products	31
2.3.2.3.	Repo and stock lending	31
2.3.4.	ISDA documentation	32
2.4.	Withholding and remittance	33
2.5.	Conclusion	34

Chapter 3: Overview of Existing National Taxation of the Financial Sector 35

by Barry Larking

3.1.	Introduction	35
3.2.	Variations on a theme	36
3.3.	Focus on three financial sector taxes	37
3.3.1.	Financial Transaction Tax (FTT)	37
3.3.2.	Financial Activities Tax (FAT)	38
3.3.3.	Bank levies	39
3.4.	Country experience	39
3.4.1.	Financial transaction taxes	40
3.4.2.	The plot	41
3.4.3.	Unravelling the plot	41
3.4.4.	Lessons learned	42
3.4.5.	Connecting factors	45
3.4.6.	Exemptions and rates	46
3.5.	Financial activities tax	46
3.6.	Bank levies	47
3.7.	Conclusion	50

Chapter 4: If It Moves, Tax It: The Financial Transactions Tax (FTT) in Colombia 53

by Catalina Hoyos Jiménez

4.1.	Introduction	53
4.2.	Main features of the tax: If it moves, tax it	55
4.2.1.	Background	55
4.2.2.	The regulation today	59
4.2.2.1.	Tax events	59
4.2.2.2.	Tax exemptions	60
4.2.2.3.	Tax base and tax rate	63
4.2.2.4.	Taxpayers	63
4.2.2.5.	Tax returns	63

8.4.1.	Introduction	135
8.4.2.	More leeway for Member States in case of harmonized rules?	137
8.4.3.	Written justification grounds	138
8.4.4.	Unwritten justification grounds	139
8.5.	Conclusion	141
Chapter 9: Taxing Financial Transactions: A State Aid Perspective		143
<i>by Raymond H.C. Luja</i>		
9.1.	Introduction	143
9.2.	State aid in a nutshell	144
9.3.	Does the State aid regime apply to the FTT?	144
9.4.	Implementation of the FTT	146
9.5.	The FTT as a penalty tax	147
9.6.	Concluding remarks	149
Chapter 10: FTT and VAT		151
<i>by René van der Paardt</i>		
10.1.	Introduction	151
10.2.	VAT system	151
10.3.	VAT as a financial burden	154
10.4.	VAT as an alternative for FTT or complementary to FTT or FAT	157
10.5.	Conclusion	162
Chapter 11: The Financial Transactions Tax vs the Financial Activities Tax		165
<i>by Daniel Shaviro</i>		
11.1.	Introduction	165
11.2.	The FTT and the FAT: A brief overview	167
11.2.1.	Prior intellectual history of the FTT	167
11.2.2.	The FTT proposed by the European Commission	172
11.2.3.	The FAT variants discussed by the Staff of the International Monetary Fund	176
11.3.	The various alternative rationales for financial sector taxation	186
11.3.1.	Raising revenue	186
11.3.2.	Ensuring a fair and substantial contribution from the financial sector	188

Table of Contents

11.3.2.1. What is the “financial sector”?	188
11.3.2.2. What are the precise grounds for favouring a “fair and substantial contribution” from the relevant financial sector actors?	189
11.3.2.3. Assessing the FTT and the FAT with respect to “fair contribution”	191
11.3.3. Reducing undesirable market behaviour and thereby stabilizing markets	192
11.3.4. Achieving coordination between different Member States’ internal taxes	193
11.3.5. Other relevant considerations	194
11.4. Over-investment in seeking trading gains as a possible rationale for a redesigned FTT	195
11.5. Conclusion	197
 Chapter 12: Financial Sector Taxation and the Ongoing Financial Crisis <i>by Thornton Matheson</i>	 203
 12.1. Introduction	 203
12.2. Bank levies	205
12.3. Financial Activities Tax	209
12.4. Securities Transactions Tax	211

The Financial Transaction Tax and the TFEU Freedoms

by Daniël S. Smit*

8.1. Introduction

On 28 September 2011, the European Commission released a proposal for a Council Directive on a common system of a financial transaction tax (FTT). This proposal aims at introducing a common FTT throughout the European Union. Since a FTT is directly targeted to financial transactions carried out on the European capital markets, the question arises how such a tax relates to the free movement provisions included in the Treaty on the Functioning of the European Union (TFEU), particularly the free movement of capital and the free movement of services. After all, those provisions stipulate that there shall be no restrictions on the free movement of capital and services between Member States. Consequently, a conflict between the proposed FTT and the TFEU freedoms potentially exists. In this paper, the question is examined whether the proposed FTT contravenes the free movement of capital and the free movement of services within the European Union.

To this end, first the rationale and core features of the FTT are discussed. Then, the proposed FTT is assessed in the light of the TFEU freedoms. Finally, the conclusion of this paper is presented. It will be concluded that the FTT is likely not to be seen as a restriction under the free movement of capital. This is because the FTT does not distinguish between domestic and cross-border financial transactions; it applies to both categories. It is recognized, however, that the FTT might also be caught by the free movement of capital despite of the fact that it is non-discriminatory. Based on the case law of the Court of Justice of the European Union (CJEU), measures that do not distinguish between domestic and cross-border situations may, under certain circumstances, still come within the ambit of the free movement of capital. This is where such measure is liable to render the free movement of capital illusory and freezes the capital market in its current state. As far as the FTT is concerned, this might be the case as far as high-volume but low-margin transactions are concerned. It is precisely this type

* Tilburg University and Ernst & Young

of transactions which the FTT is aiming at. By taxing the marginal profit of these types of transactions, the marginal profit is eroded. As a result, parties may refrain from carrying out this type of transactions. However, even in such case, the FTT is probably justified by the need to prevent future crises and the need to ensure the stability of the financial markets within the European Union. Consequently, in the author's opinion, the FTT is likely to be compatible with the TFEU freedoms.

8.2. Rationale and core features of the FTT

8.2.1. Rationale of the FTT

Before assessing the FTT in the light of the TFEU freedoms, it is necessary to identify the rationale of the FTT. Interestingly, the FTT proposal itself is not very explicit about its rationale. Still, both from the explanatory memorandum to the FTT proposal¹ and the executive summary of the impact assessment report on “Instruments for the Taxation of the Financial Sector”, dated 28 September 2011,² the following underlying reasons for the FTT can be identified.³ Firstly, the FTT proposal is based on the “polluter pays principle”, meaning that the financial sector should contribute to covering the costs of the recent global economic and financial crisis.⁴ Secondly, the proposal aims at the prevention of future crises and the stabilization of the financial markets. Accordingly, it should function as a disincentive for excessively risky activities by financial institutions and should reduce undesirable short-term and high-frequency speculative trading.⁵ Lastly, the proposal seeks to ensure the functioning of the European internal market by preventing internal market fragmentation.⁶ This could occur if each separate Member State were to decide to introduce its own FTT. In such case, possibly 27 different FTT regimes, rather than one single, harmonized FTT system, could come into existence. Such would hamper the proper functioning of the internal market.

1. Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC dated 28 September 2011, COM(2011) 594 final, Para. 1.1.1.

2. Executive Summary of the Impact Assessment Report on “Instruments for the Taxation of the Financial Sector”, dated 28 September 2011, Para. 4.

3. See also, A. Blakemore and O. Iliffe, *BNA International* 30 November 2011.

4. See Para. 1.1 of the proposal and Para. 4 of the Executive Summary of the Impact Assessment Report.

5. *Id.*

6. *Ibid.*

8.2.2. Core features of the FTT

The FTT applies to financial transactions. These are defined rather broadly and include, for example, the purchase and sale of a financial instrument (shares, securities, units, options, futures) and the transfer between group entities of the right to dispose of a financial instrument. The conclusion or modification of derivative instruments is included in the definition as well.⁷

Next, the financial transaction must involve at least one party which is a financial institution established in a Member State. Here too, the definition of financial institutions is rather broad and includes, for instance, banks, credit institutions, insurance companies, pension funds, UCITS investment funds and special purpose vehicles.⁸ Interestingly, the proposal does not give a definition of Member States. In the relations with states that are not party to the TFEU, this will not raise particular problems. Without doubt, these states do not qualify as Member States. However, this is less evident as concerns the Member States' associated and dependent territories.⁹ A large number of these territories are formally part of a Member State. On the other hand, the TFEU may not be applicable, or only to a certain extent, to these territories. Given the hybrid status of the Member States' associated and dependent territories, it would be advisable to define the territorial scope of the FTT proposal more precisely.

As concerns the taxable base, the proposal generally distinguishes between transactions related to derivatives agreements and other transactions. As concerns the first category, the tax base is constituted by the notional amount of the derivatives agreement at the time of the financial transaction.¹⁰ The applicable tax rate is at least 0.01%.¹¹ As concerns other transactions, the tax base is, in principle, constituted by the arm's length consideration in return for the transfer.¹² The applicable tax rate is at least 0.1%.¹³

7. The various financial transactions to which the FTT applies are listed in Art. 2(1) (1)-2(1)(5) of the proposal.

8. This can be inferred from Art. 2(1)(7) of the proposal.

9. See more elaborately, D.S. Smit, "The position of the EU Member States' associated and dependent territories under the freedom of establishment, the free movement of capital and secondary EU law in the field of company taxation", *Intertax* 2 (2011) pp. 40-61.

10. Art. 6 of the proposal.

11. Art. 8(b) of the proposal.

12. Art. 5 of the proposal.

13. Art. 8(a) of the proposal.

8.3. Assessment of the FTT in the light of the TFEU freedoms

8.3.1. Assessment framework

In this section, the question will be examined whether the FTT is compatible with the TFEU freedoms. In this respect, it is recognized that a three-step approach can be inferred from the case law of the CJEU.¹⁴ This three-step approach consists of the following basic tests:

- (i) Does the FTT fall under the scope of the free movement of capital and/or the free movement of services? If not, the FTT is not contrary to the TFEU freedoms.
- (ii) If so, does the FTT constitute a restriction of the free movement of capital and/or the free movement of services? If not, the FTT is not contrary to the TFEU freedoms.
- (iii) If so, is the FTT justified? If so, the FTT is not contrary to the TFEU freedoms; if not, the FTT is contrary to the TFEU freedoms.

Below, the FTT is assessed in the light of the TFEU freedoms in accordance with the above three-step approach.

8.3.2. Access to the TFEU freedoms

8.3.2.1. Free movement of capital

Based on Art. 63 of TFEU, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited. The question to be examined is whether the FTT falls *prima facie* under the scope of the free movement of capital. There is no legal definition of the concept of capital movements in the TFEU. Nevertheless, in *Luisi and Carbone*, the CJEU held in general terms that movements of capital are financial operations essentially concerned with the

14. See, for instance, ECJ 12 December 2006, Case C-446/04, *Test Claimants in the FII Group Litigation* [2006] I-11753; ECJ 18 December 2007, Case C-101/05, *Skatteverket v. A* [2007] ECR I-11531. In the same vein, for instance, D.M. Weber, *Tax Avoidance and the EC Treaty Freedoms*, Alphen aan den Rijn: Kluwer Law International, 2005, p. 3; B.J. Kieckhefer, “De (on)mogelijkheden van compenserende heffing binnen EU-verband”, *Weekblad Fiscaal Recht* 6532 (2003) pp. 914-923.

investment of the funds rather than remuneration for a service.¹⁵ In addition, in the nomenclature of the former Directive 88/361/EEC a large number of non-exhaustive examples are included. In *Trummer and Mayer*, the CJEU held that, inasmuch as Art. 56 EC/63 TFEU substantially reproduces the contents of Art. 1 of Directive 88/361, this nomenclature still has the same indicative value, for the purposes of defining the notion of capital movements, as it did before the entry into force of Art. 56 EC/63 TFEU.¹⁶ From the nomenclature it follows that the concept of capital movements consists of both financial and real capital and can be divided into three main categories: i) direct investments, such as the establishment and extension of branches or companies, and the participation in new or existing undertakings with a view to establishing or maintaining lasting economic links; and ii) portfolio investments, such as operations in securities normally traded on the capital market, operations in units of collective investment undertakings, financial loans and credits, other capital movements. In general terms, direct investments are characterized by the possibility of effectively participation in the management and control in the underlying enterprise whereas in the case of portfolio investments, there is no intention to influence the management and control of the underlying undertaking.¹⁷

If one is to compare the definition of capital under Art. 63 of TFEU to the definition of financial transactions under the proposal, one can safely conclude that the FTT falls *prima facie* under the scope of the free movement of capital under Art. 63 of TFEU.

8.3.2.2. Free movement of services

The free movement of services is laid down in Art. 56 of TFEU. This provision stipulates that restrictions on the freedom to provide services within the Union are prohibited in respect of nationals of Member States who are established in a state of the Union other than that of the person for whom the services are intended. According to constant case law of the CJEU, Art. 56 of TFEU not only addresses the service provider, but also grants rights

15. ECJ 31 January 1984, Joined Cases C-286/82 and C-26/83, *Luisi and Carbone*, [1984] ECR 377, Para. 21.

16. ECJ 19 March 1999, Case C-222/97, *Trummer and Mayer* [1999] ECR I-01661, Para. 21.

17. ECJ 26 September 2008, Case C-282/04 and Case C-283/04, *Commission v. the Netherlands* [2008] ECR I-9141, Para. 19.

to the recipient of the services.¹⁸ Art. 56 of TFEU may be invoked in situations where only the service crosses the border between Member States.¹⁹

According to Art. 57 of TFEU, services are considered to be “services” within the meaning of the Treaty where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons. Moreover, according the same provision, services in particular include activities of an industrial character, activities of a commercial character, activities of craftsmen and activities of the professions. Financial services are not excluded from this concept, although Art. 58(2) of TFEU provides for some limitations with respect to banking and insurance services. However, the concept of the provision of financial services is not defined in the Treaty or in the nomenclature annexed to Directive 88/361/EEC. Guidance can nevertheless be derived from *Svensson*. From this case it follows that transactions such as building loans provided by banks constitute services within the meaning of Art. 56 of TFEU.²⁰ It is therefore submitted that the concept of the provision of financial services must be understood as services that financial institutions provide in connection with movements of capital. The term “financial institutions” can thereby be understood – in accordance with the nomenclature annexed to Directive 88/361/EEC – as including banks, savings banks and institutions specializing in the provision of short-term, medium-term and long-term credit, and insurance companies, building societies, investment companies and other institutions of a similar character.²¹ From *Velvet & Steel Immobilien*, it can nevertheless be derived that financial services do not necessarily have to be carried out by banks or other financial institutions, as long as these activities relate to the sphere of financial transactions.²² It follows in the author’s view that financial services performed within a group of companies may qualify as well.

18. ECJ 3 October 2006, Case C-290/04, *FKP Scorpio Konzertproduktionen* [2006] ECR I-9461, Para. 32 with further references.

19. ECJ 28 April 1998, Case C-118/96, *Safir* [1998] ECR I-1897; ECJ 26 October 1999, Case C-294/97, *Eurowings Luftverkehr* [1999] ECR I-7447.

20. ECJ 14 November 1995, Case C-484/93, *Svensson* [1995] ECR I-3955, Para. 11.

21. Cf. Smit and Herzog who define the concept of “financial services” as “services that intermediaries (such as financial concerns or others) provide in connection with movements of capital”, P.E. Herzog and H. Smit, *The law of the European Community – A Commentary on the EEC Treaty*, Vol. 2, New York: Matthew Bender, 2002, Para. 67.02. See also, Baché, p. 77 et seq.

22. ECJ 19 April 2007, Case C-455/05, *Velvet & Steel Immobilien* [2007] ECR I-3225, Para. 21 with further references.

Although the provision of financial services falls under the scope of the free movement of services, the question remains whether the FTT, which links up with financial transactions provided by a financial institution established in a Member State. Here, the CJEU's case law on the relationship between the free movement of capital and the free movement of services is relevant. If one examines the case law of the CJEU concerning the relationship between the free movement of services and the free movement of capital, it appears that the CJEU addresses this question as a matter of causality. That is to say, it should be examined in each case whether there is a sufficient link, in terms of causality, between the free movement of services and the contested tax measure at stake.²³ This is, for example, illustrated by the CJEU's decision in *Dijkman*. In this case, the CJEU gave priority to the free movement of capital to the detriment of the free movement of services based on a causality approach. This case concerned a Belgian rule under which taxpayers resident in Belgium who receive interest or dividend income from investments made in another Member State were subject to a discriminatory supplementary municipal tax, unless they had elected for that income to be paid to them by an intermediary established in Belgium. The taxpayer in this case had not made such an election and was therefore subject to discriminatory taxation. On being asked whether the Belgian rules infringed the Treaty freedoms, the CJEU firstly established that the Belgian legislation is liable to affect the exercise of both the free movement of capital and the freedom to provide services.²⁴ However, it subsequently established that the case at hand related to the levy of a discriminatory tax on income from investments made in another Member State and concerned therefore the consequences of the exercise of the free movement of capital for resident taxpayers. The CJEU subsequently held that "it is precisely the exercise of that freedom which results, for the taxpayer, in the need to elect an intermediary for the payment of income from the investments concerned."²⁵ The CJEU considered that the choice of that intermediary and, consequently, the issues concerning the freedom to provide services are, in such a situation, "*secondary in relation to the issues concerning the free movement of capital* [emphasis added]."²⁶ Consequently, the contested measure was assessed only in the light of the free movement of capital. In other cases, like *Bachmann* and *Fidium Finanz*, the CJEU similarly applied a causality approach. In these cases, the CJEU reversely held the free

23. See more elaborately, D.S. Smit, *Freedom of investment between EU and non-EU Member States and its impact on corporate income tax systems within the European Union*, dissertation Tilburg University, 2011, p. 500 et seq.

24. CJEU 1 July 2010, Case C-233/09, *Dijkman*, not yet reported, Para. 30.

25. Id., Para. 35.

26. Id.

movement of services exclusively applicable at the detriment of the free movement of capital. The reason was that the link between the contested measure and the free movement of capital was too tenuous and too indirect.²⁷ Finally, in some other cases, like *Svensson and Gustavsson* and *X and Passenheim-van Schoot*, the CJEU applied the free movement of capital and the free movement of services in tandem.²⁸

In the light of this case law, the author concludes that the FTT primarily affects the free movement of capital. It is true that the provision of financial services will be made less attractive as well for financial institutions under the FTT proposal since it will raise the costs for providing financial services. However, from the angle of the FTT, such a restriction on the free movement of services must be seen as an indirect consequence of restriction of the free movement of capital.²⁹ Hence, in the author's view, absent a sufficient causal connection, the FTT cannot be assessed in the light of the free movement of services.

8.3.3. Restriction of the free movement of capital

8.3.3.1. Introduction

In the previous sections, it has been examined whether the free movement of capital and the free movement of services can actually be invoked. In this section, the subsequent question is addressed as to whether the FTT constitutes, in substance, a restriction of the free movement of capital. In this regard, it is observed that essentially two types of restriction can be distinguished: discriminatory or true restrictions and non-discriminatory

27. ECJ 28 January 1992, Case C-204/90, *Bachmann* [1992] ECR I-249, Para. 34; ECJ 3 October 2006, Case C-452/04, *Fidium Finanz* [2006] ECR I-9521, Para. 43 et seq. 28. ECJ 14 November 1995, Case C-484/93, *Svensson* [1995] ECR I-3955, Paras 10-12; ECJ 11 June 2009, Case C-155/08 and Case C-157/08, *X and Passenheim-van Schoot* [2009] ECR I-5093, Paras 32-33. In the first case, the ECJ held that the provisions at hand, which made the grant of interest rate subsidies subject to the requirement that the loan be obtained from a bank established in the Member State in question both constituted an obstacle to movements of capital such as bank loans or investments as well as discrimination against credit institutions established in other Member States. The ECJ decided in the same vein in *X and Passenheim-van Schoot*, which concerned a Netherlands tax provision allowing the Netherlands tax authorities to apply different recovery periods depending on whether concealed or unreported savings balances are held abroad rather than domestically.

29. Cf., by analogy, ECJ 3 October 2006, Case C-452/04, *Fidium Finanz* [2006] ECR I-9521.

or quasi-restrictions.³⁰ Both types of restriction may impede transnational activity, but the nature of both types differs fundamentally. The main feature of discrimination or discriminatory restriction is that transnational investment is treated less favourably than a comparable domestic investment by a single Member State. It follows that it is a relative concept and always requires a *tertium comparationis*. Non-discriminatory or true restrictions, by contrast, constitute an absolute concept that operates autonomously, independent from the treatment of other situations.³¹ A true restriction thus exists if a measure merely “deters” or “dissuades” transnational economic activity, even though the measure applies equally in a domestic context. Thus, whereas it is essential to the former type of restriction that it is discriminatory, the key feature of this type of restriction is that it does not distinguish between domestic and transnational situations.

8.3.3.2. Discriminatory restriction

According to the case law of the CJEU, discrimination can arise through the application of different rules to comparable situations³² or through the application of the same rule to different situations.³³ The fact that the discriminatory effects of a contested tax measure could have been avoided is immaterial.³⁴ When speaking of discrimination in general, one should bear

30. Opinion of Advocate General Geelhoed delivered on 23 February 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, points 37-55. Advocate General Geelhoed distinguishes between quasi-restrictions and real restrictions. Quasi-restrictions refer to “restrictions resulting inevitably from the co-existence of national tax systems.” He contends that certain disadvantages for companies active in cross-border situations, particularly those stemming from (i) the existence of cumulative administrative compliance burdens for companies active cross-border; (ii) the existence of disparities between national tax systems; and (iii) the necessity to divide tax jurisdiction, meaning dislocation of tax base, result directly and inevitably from this juxtaposition of systems. True restrictions, on the other hand, go beyond those restrictions resulting inevitably from the existence of national tax systems and refer to disadvantageous tax treatment which follows from discrimination resulting from the rules of one jurisdiction, not disparity or division of tax jurisdiction between (two or more) Member States’ tax systems.

31. A. Cordewener, “The Prohibitions of Discrimination and Restrictions within the Framework of the Fully Integrated Internal Market, in *EU Freedoms and Taxation*, F. Vanistendael (ed.), Amsterdam: IBFD Publications BV, 2006, pp. 12 and 26.

32. Cf. *inter alia*, ECJ 14 February 1995, Case C-279/93, *Schumacker* [1994] ECR I-5535, Para. 30; ECJ 29 April 1999, Case C-311/97, *Royal Bank of Scotland* [1999] ECR I-2651, Para. 26.

33. ECJ 2 October 2003, 148/02, *Garcia Avello* [2003] ECR I-11613, Para. 37.

34. ECJ 28 January 1986, 270/83, *avoir fiscal* [1986] ECR 273, Para. 22; ECJ 12 December 2006, Case C-446/04, *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, Para. 53; CJEU 18 March 2010, Case C-440/08, *Gielen* [2010] ECR I-2323, Para. 49; CJEU 1 July 2010, Case C-233/09, *Dijkman*, not yet reported, Para. 62.

in mind that this concept is by its nature a normative one,³⁵ since it always requires a judgement as to whether differential treatment is without any reasonable ground. The outcome of this judgement may vary according to time and place.³⁶ In addition, it is a relative concept since differentiation always requires two persons, objects or concepts.³⁷

The TFEU freedoms not only prohibit overt discrimination based on nationality, but also all covert forms of discrimination which, by the application of other criteria of differentiation, nevertheless lead to the same effect.³⁸ For example, the CJEU has repeatedly held that the use of the criterion of fiscal residence for differential tax treatment may give rise to covert discrimination based on nationality.³⁹ Similarly, the CJEU has held that a differential tax treatment of a resident company based on the place of residence of the shareholder of that company constitutes *de facto* or covert discrimination based on nationality.⁴⁰ Lastly, the CJEU has not limited the application of the TFEU freedoms to situations of inbound investment only. It has extended their application to outbound investment as well. In *Daily Mail*, for example, the CJEU decided in the context of the freedom of establishment that Art. 49 of TFEU also prohibits the Member State of origin from hindering the establishment in another Member State of one of its nationals.⁴¹ Since then, the CJEU has ruled on several occasions that differential treatment based on the place where a taxpayer's capital is invested constitutes a discriminatory restriction of the free movement.⁴²

35. Similarly, K. Lenaerts, "Gelijkheid en non-discriminatie in het Europees gemeenschapsrecht", in *Gelijkheid en non-discriminatie*, A. Alen and P. Lemmens (eds.), Antwerpen: Kluwer, 1991, p. 54; Isenbaert, *EC Law and the Sovereignty of the Member States in Direct Taxation*, Amsterdam: IBFD Publications BV, 2010, p. 324.

36. C. van Raad, *Nondiscrimination in International Tax Law*, Deventer: Kluwer Law and Taxation Publishers, 1986, p. 7.

37. *Id.*

38. ECJ 8 May 1990, 175/88, *Biehl* [1990] ECR I-1779, Para. 13; ECJ 13 July 1993, Case C-330/91, *The Queen/Inland Revenue Commissioners, ex parte Commerzbank* [1993] ECR I-4017, Para. 14; ECJ 7 May 1998, Case C-350/96, *Clear Car Auto Services* [1998] ECR I-2521, Para. 27.

39. ECJ 13 July 1993, Case C-330/91, *The Queen/Inland Revenue Commissioners, ex parte Commerzbank* [1993] ECR I-4017, Para. 15.

40. ECJ 8 March 2001, Case C-397/98 and Case C-410/98, *Metallgesellschaft and others* [2001] ECR I-1727, Para. 43; ECJ 12 December 2002, Case C-324/00, *Lankhorst-Hohorst* [2002] ECR I-11779, Para. 27; ECJ 17 January 2008, Case C-105/07, *Lammers & Van Cleeff* [2008] ECR I-173, Paras. 19-21.

41. ECJ 27 September 1988, 81/87, *Daily Mail and General Trust PLC* [1988] ECR 5483, Para. 16.

42. ECJ 6 June 2000, Case C-35/98, *Verkooijen* [2000] ECR I-4071; ECJ 7 September 2004, Case C-319/02, *Manninen* [2004] ECR I-7477; ECJ 18 September 2003, Case C-168/01, *Bosal* [2003] ECR I-9409; ECJ 13 December 2005, Case C-446/03, *Marks & Spencer* [2005] ECR I-10837.

Now, does the FTT constitute a discriminatory restriction of the free movement of capital based on the above principles? The answer is: no. This is because the FTT applies to each financial transaction involving at least one party which is a financial institution established in a Member State. Hence, no distinction between cross-border and domestic capital transactions is made under the TFEU. This could be different as far as currency transactions are concerned. This is because currency transactions typically most often arise in a cross-border situation. For this reason, however, the European Commission decided to exclude currency transaction from the scope of the FTT.⁴³ However, apart from currency transactions (which are thus excluded), the FTT is likely not to constitute a discriminatory restriction of the free movement of capital under Art. 63 of TFEU.

8.3.3.3. Non-discriminatory restriction

Above, it was established that transnational investment can be impeded not only by discriminatory or true restrictions, but also by non-discriminatory or quasi-restrictions. It is this last type of restriction that is subject to examination in this section.⁴⁴ When addressing this question, the starting point must be that the Treaty freedoms “are not concerned with any disparities in treatment which may result, between Member States, from differences existing between the laws of the various Member States, so long as they affect all persons subject to them in accordance with objective criteria and without regard to their nationality,” as the CEJ ruled in *Perfili*.⁴⁵ From *Schempp*, one can furthermore infer that this approach also holds true in the field of taxation. In this case the CJEU ruled that the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation.⁴⁶ It added that, given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen’s advantage in terms of taxation or not, according to circumstances.⁴⁷ Accordingly, one cannot invoke the Treaty freedoms for the simple fact that less strict rules

43. Executive Summary of the Impact Assessment Report on “Instruments for the Taxation of the Financial Sector”, dated 28 September 2011, p. 41. This applies to both EU and non-EU currencies.

44. In more depth on this type of restriction in the field of taxation, for instance, A. Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht*, p. 342 et seq.

45. Cf. ECJ 1 February 1996, Case C-177/94, *Perfili* [1996] ECR I-161, Para. 17 with further references.

46. ECJ 12 July 2005, Case C-403/03, *Schempp* [2005] ECR I-6421, Para. 45.

47. Id. See also ECJ 23 October 2008, Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* [2008] ECR I-8061, Para. 50.

apply in other Member States.⁴⁸ Hence, at first glance one could conclude that non-discriminatory tax restrictions are not governed by the Treaty freedoms.

Despite the above, the CJEU has nevertheless decided in a number of cases that non-discriminatory restrictions can also be caught by the Treaty freedoms. This extension of the scope of the Treaty freedoms was allowed for the first time in *Rewe-Zentral*.⁴⁹ In this case, the CJEU ruled that

[O]bstacles to movement within the Community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognized as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer.⁵⁰

Thus, in this case the CJEU essentially accepted that restrictions resulting from disparities may also be caught by the Treaty provisions, by introducing at the same time a new set of justification grounds in addition to those written down in the Treaty, which is nowadays commonly referred to as the “rule of reason”.

This raises the question: Under which circumstances can non-discriminatory restrictions still be caught by the Treaty freedoms? From subsequent case law of the CJEU one can firstly deduce that a non-discriminatory measure may be caught by the Treaty freedoms where it imposes conditions for market access without considering comparable conditions already imposed in the other Member State. This latter principle is also referred to as the principle of mutual recognition.⁵¹ In the context of the FTT, this principle, however, is not relevant. This is because there will be nothing to recognize under the proposal. Rather, the proposal precisely introduces a common FTT system applicable in all Member States. The mutual recognition doctrine therefore plays no role in this context and needs not to be elaborated on for purposes of this paper.

Secondly, from the case law of the CJEU one can deduce that a non-discriminatory restriction exists where a national provision *directly restricts*

48. ECJ 10 May 1995, Case C-384/03, *Alpine Investments* [1995] ECR I-1141, Para. 27; ECJ 14 July 1994, Case C-379/03 *Peralta* [1994] ECR I-3453, Para. 48.

49. ECJ 20 February 1979, 120/78, *Rewe-Zentral AG* [1979] ECR 649.

50. *Id.*, Para. 8.

51. See, e.g. A.C.G.A.C. de Graaf, *De invloed van het EG-recht op het internationaal belastingrecht: beleids- en marktintegratie*, Deventer: Kluwer, 2004, p. 320.

Notes

Notes

Notes

Contact

IBFD Head Office
Rietland Park 301
1019 DW Amsterdam
P.O. Box 20237
1000 HE Amsterdam, The Netherlands
Tel.: +31-20-554 0100 (GMT+1)
Fax: +31-20-620 8626
Email: info@ibfd.org
Web: www.ibfd.org



IBFD, Your Portal to Cross-Border Tax Expertise