Insideview

"The Planned Financial Transaction Tax is Untenable"

INTERVIEW WITH THOMAS RICHTER, GERMAN INVESTMENT FUNDS ASSOCIATION

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The European financial transaction tax (FTT) remains on the political agenda. After plans for an EU-wide FTT had been scuppered by the UK, eleven member states led by France and Germany entered into an "enhanced cooperation". A second proposal put forward by the Commission is currently subject of protracted negotiations.

Do you think the latest proposal will be more successful than the first attempt?

No. The proposed tax would still be economically damaging and legally untenable.

Can you explain why?

According to the proposal, the FTT will apply if at least one party to the transaction is established in a participating member state. This so called residence principle has already provoked disagreement. The British and Americans in particular have little enthusiasm for it. Their financial institutions would be treated as resident in the participating member states. They would have to pay tax simply because they enter into transactions with other financial institutions located in a participating country. They would have to make tax declarations in all eleven countries and establish the infrastructure for meeting those tax liabilities. The UK has already lodged a challenge at the European Court of Justice. The residence principle may infringe the international law principle of territoriality.

Would this be the only legal issue raised by the proposal?

No. The second pillar of the draft directive is the issuance principle. It would apply if a financial instrument issued in a participating member state is traded outside the eleven participating member states. This raises questions not only regarding the principle of territoriality. How is Germany to go about collecting the tax if you have a bank in China selling German equities to a bank in Australia? In Germany, tax laws are unconstitutional, if they are unenforceable. The German focus, therefore, will not be on the issuance principle.

France, however, introduced a FTT based on this exact principle in 2012 ...

The French model is proving to be problematic. Citing the principle of territoriality, some German banks are refusing to pay the tax to France. If they pay, the situation will be absurd. Since the tax is imposed on the transaction, German taxpayers dealing in French equities could set the tax against their German tax liability. Germany's exchequer would effectively be acting as a source of revenue for the French government!

Besides the legal issues: How would the FTT impact the fund industry?

For German financial institutions the competitive disadvantages would be considerable. Hubs, such as Luxembourg, would benefit by attracting new fund business away from German supervisory control. As the tax would be levied on fund assets, it would directly affect private investors. If we look at pensions, the result would be a striking paradox. On the one hand, the state provides billions of Euros in subsidies for pensions, while on the other the tax would take a hefty slice out of investors' savings. A FTT on repo transactions and market making would also make it harder to ensure the required liquidity for banks and the financial market as a whole.

Looking ahead, what do you expect will happen?

Most voters are in favor of the FTT because they do not realize that they would end up paying it, too. According to a representative survey conducted by BVI once this misunderstanding is clarified most say they are against the tax. Let us see, whether common sense returns now that the election campaign is over.

Thank you for this interesting interview.