HOUSE OF LORDS

EU ECONOMIC AND FINANCIAL AFFAIRS SUB-COMMITTEE

Financial Transaction Tax: Alive and deadly

Evidence

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Evidence Session No. 1 *Heard in Public* *Questions 1 - 12*

WEDNESDAY 2 OCTOBER 2013

9 am

Members present

Lord Harrison (Chairman)
Earl of Caithness
Lord Hamilton of Epsom
Lord Kerr of Kinlochard
Lord Vallance of Tummel

Witness

Heinz Zourek, Director General, DG Taxation and Customs Union

Q1 The Chairman: Mr Zourek, thank you ever so much. Perhaps you would like to introduce your colleagues, and I will then explain a bit about what we are doing.

Heinz Zourek: I have here the two real experts, Carola Maggiuli and Pol Vermote, and my assistant Stephane Mail Fouilleul. I have seen from your questions that you are very interested in legal considerations. I am an economist and would rather invite colleagues who are trained tax experts to respond in more detail on the points that you would like to hear about. That is why I have invited them to come. The meeting will be more useful to you because you can get the Commission's thinking on this process.

The Chairman: Thank you very much for that introduction. Please, first, pass on our very best wishes to Commissioner Semeta, who came before our Committee at the earlier stages of the examination of the financial transaction tax. I am sorry that he was not able to be here today, but if and when he is passing through London, there is an open invitation to him to renew our acquaintance. My colleagues around the table will introduce themselves as we get to the questions. We are here on an inquiry principally into genuine economic and monetary union, but we have done a lot on the financial transaction tax. We published a report last year, which I think you may have seen, and released an update in March this year. Mr Manfred Bergmann came before us to help us with a better understanding of the FTT. As you know, I think partly spurred on by the Committee's two reports, the UK Government have made legal challenges. It would be helpful if you, or your colleagues who have a legal bent of mind, could say, first, where we are with that and, secondly, in the light of the finding by the Council legal service, whether the way that this project was sired puts it under some kind of cloud. It would be good to hear a resumé from you or your colleagues of where we

stand at the moment. We have thoughts and criticisms that we would like to make but it would be best to see where we are first.

Heinz Zourek: Thank you. First, I return the compliments from Commissioner Semeta, who told me that he was very interested to meet you and enjoyed the meeting. Yesterday, he forwarded a draft response to your letter to his colleague Mr Sefcovic. In the Commission, we have a Commissioner who is in charge of relations with the national Parliaments. He has now forwarded his draft response, so I hope that it will be signed in the course of this week and we will then have the response at your earliest convenience.

Secondly, in response to your question about the state of play, I would summarise it in the following way. The Commission's proposal from spring this year, following the authorisation for the use of the enhanced co-operation procedure, has been discussed in the appropriate forum of a Council working party, as they are usually called. This typically happens in two stages. The first is a reading of the proposal, simply to give all the participants a chance to understand the exact meaning and content of the provisions. It is just a reading, although appropriate questions were asked to enable better understanding. Once that has finished, the second phase is the negotiations themselves, when member states come in with their positions—whether they would like something reinforced, taken out or done in a staged or staggered way. We are currently at the turning point where the reading has finished and the substantial negotiations are due to start. This also relates slightly to one point that you raised, which is that, during this meeting, the Council legal service came up with an opinion, which was addressed to the member states in the Council working group. Some liked it while others disagreed with it. The Commission simply took note of it. It is a debate between two legal services. We, as a Commission, follow the opinion and instruction of the Commission's legal service[1]; the Council's legal service has its own views. This is a common situation, of legal services expressing their assessment.

The Chairman: Will the Commission's legal service publish a response and analysis?

Heinz Zourek: We have asked our legal service to prepare a response in the same way that the Council's legal service has addressed their concerns to the working party. Whether this draft will then be published or not, is yet to be decided. Typically, I am not very interested in the debates conducted by legal services among themselves.

The Chairman: Right, but you are interested in the legal aspects of how the enhanced co-operation was used and so on?

Heinz Zourek: Yes, but that is a side aspect and we leave it to the experts.

Q2 Earl of Caithness: If you take that view, when do you expect this legal position to be resolved? It is critical to what the tax might look like. If the legal opinion of the Council of Ministers is correct, you will have to completely redraft your proposal. What do you think the timescale is?

Heinz Zourek: First, I would look at how the member states react—whether they share that reading of it. I have had no indication from among the 11 that they will agree with the assessment. The latest point is the Court of Justice. If there is an agreement among those states and they adopt it, and it was challenged by someone who was unhappy with it, it would be for the Court of Justice to settle it.

[1] This will in fact be an opinion of the Commission Services

Earl of Caithness: Just so that I am clear, for the moment you are going ahead with the Commission proposal for the full FTT, ignoring the opinion of the legal service.

Heinz Zourek: It is the member states. We do nothing. We are just observing the negotiations, but we have no intention of changing the proposal.

Pol Vermote: I would like to add that in fact the Council legal service opinion objects to only one particular paragraph of the proposal, which is on the territorial application of the proposed tax. So it is not that the whole proposal would collapse. Also, it is only one opinion. Of course, the Commission has also analysed all this before proposing it. It has looked at the different aspects of the proposal and it would of course agree to some refinement in the negotiations, where it considers this appropriate.

Earl of Caithness: Has your legal opinion given you confidence that you have respected all the competences and rights of the non-participating member states, so that all 28 states are being treated equally?

Heinz Zourek: Frankly speaking, we have great difficulty even understanding the meaning of the opinion of the Council legal service because they have argued that the competences of the non-participating countries would be impacted. This is impossible for us to understand because no one who is not participating would be bound by this agreement. If a non-participating country wants to introduce, retain or withdraw its existing or planned FTT, it is free to do so. There is no impact on the competence, liberty or choice of any non-participants member state; they can do as they like. Infringement or an impact would happen if agreement among the 11 forces them to become active. They would simply watch this.

Just to be clear, the whole proposal from the Commission is based on the internal market provision because at present we have a situation where financial transaction taxes are in place in a number of member states—almost half of them. The only thing that we looked at was whether we could find a solution so that all those who have a financial transaction tax, or would like one could decide on it while at the same time reducing the risk of double taxation. The only area where double taxation in financial transaction taxes would not occur would be within the group of those which applied the harmonised tax. The point is that whether this proposal is adopted or not, it does not in any way prevent non-interested countries introducing an FTT as they like. It is not a yes or no, it is whether it is harmonised or not.

Q3 Lord Vallance of Tummel: Does that mean that there is no obligation on a country outside the group to raise the tax?

Heinz Zourek: Yes.

Lord Vallance of Tummel: Let us be specific and take an easy one first. Let us go to New York. We will suppose that there is a transaction between a British bank and an American bank involving, let us say, a Volkswagen share. There is no obligation upon either of those parties, the British bank or the American bank, to raise this tax. Is that what you are saying?

Heinz Zourek: The difference is that we have to draw a distinction between companies and states. Typically, collecting a tax is the business of the state or a public authority.

Lord Vallance of Tummel: The two things are interconnected. The company pays the tax which is raised by the authority. I am not too fussed about the difference between who raises it and who pays it, but about whether there is an obligation on any of these parties to raise the tax.

Heinz Zourek: Yes, there would be. If an emission principle is followed, as it is in some of our member states' legislation, then, yes, it would be an obligation.

Lord Vallance of Tummel: There would be an obligation, obviously, in London for the same transaction. If the transaction were to take place in London—

Heinz Zourek: I would say that the place where the transaction is made is irrelevant.

Lord Vallance of Tummel: So, in effect, there is no way in which, in that respect, the UK or any non-participating country can avoid this tax or the raising of this tax or the implications of this tax.

Heinz Zourek: For the country, yes, but not for the actors.

Carola Maggiulu: There is a difference between the tax authorities—the UK as an authority—and a UK citizen or UK resident.

Pol Vermote: That will be a legal matter.

Lord Vallance of Tummel: You shook your head earlier. Do you have some doubts about this?

Pol Vermote: What I mean is that Mr Zourek is right in saying that there are two different types of jurisdiction. There is the prescriptive jurisdiction: can a member state say, "We are going to tax a US company"; would it have the right to do that? That is the prescriptive jurisdiction. In our proposal, we think yes. Under all the criteria as defined, we think that there is a sufficient link to the taxing jurisdiction—in this case, a participating member state. There is also the jurisdiction, which I think is what you are referring to, of enforcement, saying, "Look, we are going to collect this tax. You have to pay. We have the right to do this." The second step is: how can we collect the tax? The proposal does not have a lot of detail on that because it is a directive and that is typically a competence of member states.

Lord Kerr of Kinlochard: But you do not need to include any detail now because the link already exists, through the requirements of joint and several liability, or mutual assistance. One way or another, the British fisc would be responsible for ensuring that the German fisc, in Lord Vallance's example, received the tax due on the transaction between the British and the American bank if it had happened in London. Even more implausible, the American fisc would be responsible and the German fisc would be expecting the American tax authorities to collect the tax on the transaction that took place in New York.

Heinz Zourek: We have to make a distinction between tax collection in a kind of regular way and executing or helping in administrative co-operation in a process where all the national measures to collect tax have been relaxed. You have to make a distinction between a kind of regular tax collection duty and co-operating with another administration in contentious cases, pursuing the recovery of tax after all other means have been exhausted. One is a kind of regular collection and the other is that the tax authorities receive a request for administrative co-operation from another tax authority to help to collect the tax where in the EU they will then deduct from the revenue the costs incurred in the requested member state, if these were not paid by the person liable. This is a basis of administrative co-operation among tax authorities.

The Chairman: You, sir, Pol Vermote, were nodding in agreement with Lord Kerr. Then you stopped nodding when we got on to the aspect of the obligation, which we understand to be the case, that it could fall to the London authorities to collect the tax that should otherwise be taken by the United States authorities. I wonder whether you could give us—

Pol Vermote: I know that it is part of your last letter, where you very much insisted on a reply. As Mr Zourek said, you will receive the reply soon. The collection will also be part of the discussions in the Council. The Commission actually left it open to a certain extent because we deal with a proposal for a directive. Under subsidiarity principles it is left to the member states, but the Commission said in its proposal, "We want, if you like, to put together implementing acts". So, on tax collection, there will need to be in place straightforward measures on how to collect the tax because one cannot go immediately to joint and several liability. That is not the purpose of tax collection mechanisms. There need to be systems in the first place. Joint and several liability as a kind of method of second resort, one could say. That is possible. We consider that the other party in the transaction can be held liable to pay because we consider that there is a sufficient link—a nexus—to the taxing authority.

Q4 Lord Kerr of Kinlochard: I am sorry but there are four things wrong with that argument, if I may say so. First, I do not accept that you can distinguish between the levying of a tax and the collection of a tax. It seems to me that they are automatically linked. Secondly, it seems to me that if you are arguing that non-participating member states can do as they like and they do not need to raise this, you are suggesting that the enormously important global concepts of mutual assistance and joint and several liability could be set aside, and that this would not bother the Commission. Thirdly, you are saying that these issues of collection will be sorted out in the Council—"That's fine. The Commission doesn't need to worry about this. The Council will sort it all out". But it is not the Council; the Council is not involved. You are talking about enhanced co-operation among 17 or fewer of the member states. Fourthly, I would draw your attention to a point in the Council Legal Service's opinion of 6 September, which I think is incontrovertible. They say, "By virtue of non-harmonised national tax legislation, double tax relief would still result in the levying of tax by participating member states with respect to situations that are the primary competence of non participating member states. Financial transactions concluded by financial institutions in non-participating member states would still in a vast majority of cases contribute to the budget of participating member states, whilst transactions by financial institutions resident in participating member states would never contribute to the budget of another member state". It seems to me that you can say, if you like, that that is not the concern of the Commission—that its concern is not with collection and that this can be sorted out in the Council, but I find it very odd if that is indeed your argument.

Pol Vermote: I am sorry, sir, it is not really what I said. What I said was that it is our concern because the Commission proposed for it to adopt implementing acts on this. But, as I look at indirect taxes, in most cases the collection mechanisms are organised in the member states.

Heinz Zourek: It remains a member state's prerogative. We would, however, be ready to come up with a proposal on how to organise it better. But the competence of organising the collection of tax—the same goes for energy tax, alcohol tax and tobacco tax—is never laid down in our directive. How member states should charge and collect the tax on spirits is for member states to organise. The only thing is that we have in the directive a description of which liquors or energy are subject to tax. The point is that we need to have the agreement or authorisation of the member states to interfere with their prerogative relating to the collection of the tax.

Lord Kerr of Kinlochard: I am sorry, but there is a flaw in that comparison with liquor taxes. Because of joint and several liability and mutual assistance provisions, of course if all this happened the British fisc would be collecting the tax for return to the German fisc or

another fisc. Of course they would if all this happened. Therefore, all the risks to the London market, which are much talked about—this grit in their machinery, this likelihood of business leaving London and going somewhere else—would be being run. But the British themselves would not be taxing this liquor. The British themselves would not be taxing, and slowing down their market: they would be doing it by collecting the German tax. In your liquor example, if there are taxes on liquor in all our countries, then of course what you say would apply, but the point is that this financial transaction tax would not be applied by the British Government: it would be collected by the British authorities for the Germans. So I do not think that your analogy with respect to this is quite right.

Heinz Zourek: No, my point was not about who is doing it. My point was that how to do it would be decided by member states. We do not prescribe in the directive the way that this tax has to be collected by member states.

Lord Kerr of Kinlochard: You do not need to.

Heinz Zourek: That is the reason why we do not do it. Secondly, we would not be entitled to do so without being requested to do so, because according to subsidiarity rules it is the prerogative of member states to organise tax collection in the way they like to have it.

The Chairman: But I think you are saying that joint and several liability is the default position along with mutual assistance because that is general. That would then surely apply.

Heinz Zourek: Yes, it could apply.

The Chairman: But that then has the payback or the wash back on to the British system. Lord Vallance's example is a clear demonstration of what worries and concerns us. In the case of the London arm of it, there may be not only the obligation to transfer the tax on the German investment but, in the default of the American element of the transaction, a liability on London.

Q5 Lord Vallance of Tummel: I think we are getting a little bit down the line. When Manfred Bergmann came to give evidence, he made it quite clear that there would be no legal obligation on the UK tax authorities to collect the tax. Full stop. What I think you are saying is that there is an obligation to collect it but that how you collect it is a matter for the UK fisc. So the "whether" is a given, but the "how" is difficult to determine.

Lord Kerr of Kinlochard: Is your point then a different one—that there is no obligation laid down in the text where the Commission spell out their proposal? There are, however, applicable obligations extant, so, on a narrow point, you are not creating a new obligation, because the obligation exists already?

Pol Vermote: I think that Mr Bergmann has said this. First, as we explained, there are these basic collection methods, and the UK could not be obliged to put collection methods in place but it could be done on a voluntary basis. I think that is what he said. If there is an agreement, for example, then it is okay.

Heinz Zourek: Again, we make a distinction between the regular collection of a tax and administrative co-operation in the case of a recovery, but one tax authority will then also invite another tax administration to co-operate. This is not regular collection: this is the case of recovery of an unpaid tax where tax authorities would like to recover what is due. We make a distinction between regular business and cases where there is co-operation. I would rather compare it with, say, VAT. When you order anything from Amazon.com—say, a film, an e-book or music—Amazon will charge VAT for the country in which you are located. So they will charge UK VAT when you are resident in the UK, they will charge the Belgian VAT

rate when you are resident in Belgium, and they will charge German VAT when you are located in Germany. They are under an obligation to do so when they enter into business with a resident in the Union.

Lord Kerr of Kinlochard: I think we understand that, Director-General, about VAT. My concern is with the Financial Transaction Tax. Are you now telling us that you do not dispute the quotation from the Council's legal services opinion which I read out? Or the fact that, "transactions concluded by … institutions in non participating Member States would … in a vast majority of cases contribute to the budget of participating Member States, whilst transactions by financial institutions resident in participating Member States would never contribute to the budget of another Member State?" Are you saying that that is true, but simply the result of voluntary arrangements which have nothing to do with your proposals?

Heinz Zourek: I agree that this is true but it is irrespective of the emission principle. It is also emanating from the residence principle. When you have a transaction, because the first example was one where there was no other link to the participant—

Lord Vallance of Tummel: The deemed residence.

Heinz Zourek: No, but in your first proposal there was only—

Lord Vallance of Tummel: It was in New York.

Heinz Zourek: And it was of the Volkswagen share where only the emission was the link. Let us assume that member states would not go down there. This has been added by the Commission and it differs from the original proposal, where we were working with only the residence principle, because of possible tax avoidance some member states and the Parliament wanted to have its range increased by the emissions principle, which is applied already in some of our member states. Having only the residence principle would lead to a situation where there are two financial institutions: one resident in a participating state and one in a non-participating state. Both legs of that transaction would be liable for the tax in the participating country. If this is not collected in the non-participating country, it would be collected twice in the participating country. There is even a risk that this transaction will be subject to another non-harmonised financial transaction tax in the country that is not participating but has a financial transaction tax of its own. That is exactly the double taxation situation which is the result of non-harmonised taxing systems. In this way, I agree with the reading that in cases of such protections the benefits and revenues of this tax would go only to the one country—the participating one. If, however, it were to be a transaction among financial institutions which are both located in the respective participating countries, it would go to the benefit of the participating countries. That is the construction.

Pol Vermote: These voluntary agreements I referred to are on the tax collection, not on the budget.

Q6 The Chairman: Can you tell us what conversations you have had with HM Treasury about this on the objections that have been raised by the United Kingdom Government, especially in respect of the obligations of non-participating countries? Have you been in touch or sat down, as we are today, and talked to the Treasury?

Pol Vermote: To my knowledge, it is only in the framework of the Council working party that we have conversations with the UK.

The Chairman: Right. You have not had any separate attempts to try to clarify—

Heinz Zourek: No. Not to my knowledge.

Lord Kerr of Kinlochard: But to the extent that they happen in Europe, the great bulk of the transactions which will be caught by this enhanced corporation tax in a member state will happen in London. That is where more than half of them will take place. Maybe you should be talking to the market and the authorities of the market upon which you are going to have the most impact, with the additional paradox that you will be having no positive effect from the UK's view, as there is more work—

Heinz Zourek: Well, our proposals are not secret so whoever has a concern is invited to come, as you do.

Lord Vallance of Tummel: This would apply to the United States, so you will not in fact have spoken to any of the major financial centres in the world.

Heinz Zourek: The point is that talking to all these institutions would make much more sense once you have an idea of what the real outcome would be. Just to be clear, what we proposed was the broadest possible proposal. When you go back to the proposal's history, what was behind it? It is a harmonised tax which should raise revenues; that is point number one, three, six and 10. Thereafter, there are some other considerations but its purpose is to raise revenues. We are departing from a point where we said that to raise revenues we would like to have the broadest possible tax base with the lowest possible rate, so that this would have the least effect in changing patterns and in favouring some transactions or products. What we did, upon request from member states, was to say that we would bring the biggest possible blanket and have the scissors to cut out whatever we dislike. The same process is at present under way among the 11, where they now have a proposal where I think you cannot easily imagine going further. They are then negotiating among themselves what they consider to be fit for their purpose.

Only once you have established more agreement on what is to happen and how—that is, will it be a kind of a Big Bang or have an incremental introduction in phases or stages? Will it be automatic or will it be triggered off by whatever trigger mechanism? That will have a big impact on the practicalities of the collection and the impact it might have on different financial markets. On the point of negotiating with or contacting them, once you say "I am thinking of buying a vehicle without having decided whether it is an airplane, a car or a coach", it is difficult to really start negotiating. The point is that we are in a situation where we do not yet know the outcome.

The Chairman: Let me return to Lord Kerr and then Lord Vallance, and then towards the end I would like to bring in Lord Hamilton to try to look to the future.

Q7 Lord Kerr of Kinlochard: I am grateful for that explanation. It leaves me with three fundamental problems. I do not think that you can make tax policy in a vacuum; I think that you have to go and look at the markets. It may be that the effect on markets is being exaggerated—I do not know—but clearly there will be some effect on markets. If the Commission is saying, "We can only do that once the plane is designed", I do not understand it. That is too late. It seems to me that that discussion should have been taking place when the matter was in the full Council and should now be taking place when it is in the enhanced co-operation. That is my first worry. My second worry is the washing-one's-hands argument—the argument that says, "Tax collection is none of our business. If you have mutual obligations to each other, that is entirely voluntary and you can go off and do that. It is nothing to do with us how the tax is collected". That seems to me a difficult argument. My third problem is that I had always thought—and this is one of the things that I most admired about the Commission—that one of the key jobs of the Commission as guardian of the treaties was to make sure that all member states, large and small, had equal

rights and were treated equally. Partly because the "deemed residence" doctrine and partly because of the way you changed the proposal from the one that was in the Council to the one that is now in enhanced co-operation, which produced the effect that has been described and you accept is correct, I do not think that the Commission is looking after the rights of the member states that are not participating in this. That really alarms me.

Heinz Zourek: Perhaps I can respond only to the last point and then invite Carola to come in on the other two. The fact that there is a group of member states that want to pursue a project which others have said they do not want leads to a situation where there are two different kinds of member states, those that are in and those that are out. This will unavoidably lead to a difference in the situation in the two camps. That is the question whether you would accept enhanced co-operation at all. This is unavoidable. This is the sheer principle of it.

Lord Kerr of Kinlochard: The treaty is clear that the enhanced co-operation must not affect the interests of non-participating member states in these areas. That is what the treaty says.

Heinz Zourek: The point is, however, the impact on the interests of third countries, of the non-participating countries. Our legal service confirms that there is no impact of the proposal that would be seen as not being in line with this Treaty obligation. I follow the thinking of my legal service and not of somebody else's legal service.

Lord Kerr of Kinlochard: That presumably is hung on the narrow point that since there are no provisions for collection in your proposals, you have no responsibility for the effects of how this is collected.

Heinz Zourek: No, I would not agree with this. We have much more fundamental reasons.

Q8 The Chairman: Before you bring Carola in to respond to the other two points made by Lord Kerr, perhaps I can ask whether we are getting to the point where you feel in your bones that the enhanced co-operation procedure is such that to invoke it might always mean a clash with the defence of the EU 28 as a whole? Might this matter be in time one for treaty change?

Heinz Zourek: It has been introduced as a remedy to a desire of a group to go ahead faster or more in depth than others while still being entitled to use the tools of the Union—that means, for instance, the role of the Court of Justice to rule in the case of a dispute. It was a decision of the member states when they were drafting the treaty to make such a provision. However, you cannot deny that the fact that you are introducing a set of rules only in one subsection of the 28 creates a difference between the member states and is having an impact on the harmony.

The Chairman: I am grateful for that answer. I was asking you a question that is way above your pay grade, so I am particularly grateful that you have replied to it.

Carola Maggiuli: I want to say just one thing on contact with the market. We have constant contact with them. We had hundreds of meetings—I am not exaggerating—with the private sector, the institutions and the political side, so it is not correct to say that we are conducting our policy initiatives without contact with interested parties. What Mr Zourek was saying was that, before contacting parties in practice and in order to implement the collection of the tax, we need to have a clear idea of what the tax will be. We need to be able to present technical elements in order to have technical replies. We have already had meetings with parties who might be interested and involved even in the collection. We

are therefore preparing everything, but it is premature, before knowing the details of the tax, to fix the technicalities of the collection.

The Chairman: I am grateful for that. If I understand correctly what you have said to us, in answer to Lord Vallance's point about talking to the major financial centres of the world, you could give us a list of those who have been consulted, which would help us understand that that has been the case.

Heinz Zourek: If you insist that it is not complete, I have a very long register of visits.

The Chairman: The criterion would be that they were representative. That would be so useful.

Carola Maggiuli: The last meeting that we had was yesterday. It was with an association of asset managers.

Heinz Zourek: We will try to do our best to produce this kind of list.

The Chairman: That would be extremely helpful.

Q9 Lord Vallance of Tummel: I should like to come back to the Council legal service's opinion. Of the three bullets, two were purely legal—the first being that each "Member States' jurisdiction for taxation under the norms of international customary law" was exceeded, and the second that it is "not compatible with Article 327 TFEU". The third one is more economic: they reckoned that it was "discriminatory and likely to lead to distortion of competition to the detriment of non participating Member States". Can you respond to that? Is it discriminatory or not? That is an economic question. It is not just a legal question.

Heinz Zourek: It depends on how you define discrimination. Do you define it as treating equals differently or say, as I would, that there is a difference because different things are treated differently: some are ins and some are outs? Therefore, discrimination would be a viable concept only if there were a different treatment within the two groups considered to be equal in this context. Therefore, I would not share the view that there is discrimination. However, I would agree that the effect of such a tax is different in the ins and the outs, but that is the case for any tax that is introduced in one jurisdiction and not in the other.

Lord Vallance of Tummel: Would you say that something that results in distortions of competition is, by definition, discriminatory?

Heinz Zourek: No, I would not. Secondly, the point is that I have difficulty in understanding that either of the two options is always negative. Those that opt not to participate do so because they consider that to be in would be detrimental to their interests. To claim at the same time that also to be out is detrimental in the same way does not convince me. So it is either bad to be in or bad to be out but I do not agree that there is a situation without that option.

Lord Kerr of Kinlochard: This is a fascinating argument. It is like saying that the CFP is not discriminatory against Austria and Luxembourg. The people in this building who make the Common Fisheries Policy do not discriminate against Austria and Luxembourg, who have no sea in which to fish, but if they created regimes that were different for Spain and Denmark, then there would be a problem. That is where we are now.

Heinz Zourek: No. This is my response to the enhanced co-operation. When you have divorce law, which is different in those countries which have been agreeing in enhanced co-operation to accept divorce judgments and not in those which are out, this is the discrimination: a deliberate difference that they seem to have.

The Chairman: You have made your assistant smile with the tenor of that response.

Lord Vallance of Tummel: It is a distortion.

Pol Vermote: If you look at the Council Legal Service's opinion you referred to, in respect of discrimination and distortion of competition, that is actually a very legal opinion and not an economic one.

Q10 Lord Hamilton of Epsom: Whether you have talked to markets in New York, Singapore and Hong Kong or not, I imagine you presume that they are neither going to levy nor collect this tax. Is that not your presumption?

Heinz Zourek: No. It can be a business to collect it.

Lord Hamilton of Epsom: You think they might collect this tax for you in New York?

Heinz Zourek: Yes, when they make a business of it. It depends on the conditions when you levy the tax. The market organisers, the stock exchanges, collect fees for transactions anyway. When they add to this fee the margin that is the tax and they get reward for this, they can make a business out of collecting the tax. It would reduce the revenues for the member states entitled to get it, but it could be a business.

Lord Hamilton of Epsom: But they do not get a reward. The tax goes back to Germany on the Volkswagen shares.

Heinz Zourek: No, that depends on the agreement between the German tax people and the stock exchange. When they say, "You are collecting this tax but you can keep it for six months and get the interest; we only get it sent to us after a year", the stock exchange will say, "Oh, that is a good business".

Lord Hamilton of Epsom: On the other hand, if they refused to both levy and collect the tax, there would be a great incentive for Volkswagen to ensure that it was listed on the Hong Kong, Singapore and New York stock exchanges, would there not? Therefore, the trade would be more likely to happen in those financial centres than they would either in London, Frankfurt or anywhere else where they previously traded.

Heinz Zourek: Without being cynical, that is a consideration for the member states that asked the Commission to come up with the proposal. If they would like that to happen, then it is their business. We made a proposal that followed an idea that said, "Please design a financial transaction tax that can be constructed as AAA with all markets, all products and all actors". That was the request. To be honest, it is not the first initiative of the Commission to come up with a financial transaction tax. We were also looking at an equity-rated tax and all the others. But it was then the consideration that said, "What would be a tax that avoided a number of unwanted side-effects and also had a chance to create revenues in those member states that have very small activity in emissions securities?". When you have the emissions principle, that would of course be a much better situation for those that are very active in emissions. There are member states that have very low emission activity there but their financial institutions are engaged in a large number of transactions. So there were also the considerations of a completely different nature. Again, for us one of the main missions of the financial transaction tax was to create revenues. To give you an order of magnitude, we had a rule of thumb calculation behind it. We said that if we could create a tax that represented revenues of about 0.5% of GDP, it would take 40 years to compensate the 20% of public finance needed to rescue the financial system. This was the main consideration behind it. Again, we can discuss a lot of the side-effects, but we still consider them to be the side-effects of a tax designed to generate revenues. I do not disagree with

what you say that a tax increase has an impact on those who have to pay it. I do not contest that. The point is only that we want this to be done in a way that enables an FTT system and that, when we do it in a harmonised way, there will be no double taxation within the group that adhere to the harmonisation process. On the other hand, it would avoid having a growing number of unrelated and non-harmonised financial transaction taxes. You have seen that, since the proposal from the Commission, France has introduced one, Italy has introduced one and there are others thinking about it if we do not produce the requested result.

Lord Hamilton of Epsom: London already has stamp duty. How would you see that interacting with the financial transfer tax? Would the financial transfer tax be in addition to stamp duty?

Heinz Zourek: Yes, this is a typical case of double taxation. This might lead to a transaction that is on the one hand charged stamp duty in London and on the other hand charged FTT in the country that applied it.

The Chairman: Do you think there will be a watering down or change for the re-presentation of the financial transaction tax? Do you think there might be a version that mirrors stamp duty tax in the UK?

Heinz Zourek: I would not speculate, but I do not exclude it. It depends on whether this would be agreeable among the member states, because we have a unanimity requirement among the 11. The only way to get it is when they agree unanimously. Therefore, you can say that the weakest link is deciding on the strength of the chain, or the slowest boat determines the speed of the fleet—whatever you want—but it is not in our hands. Again, this is what we propose.

The Chairman: Let us finish with Lord Kerr, and then I will draw matters to a close.

Q11 Lord Kerr of Kinlochard: You have made a gallant defence of the position. Looking back on it, do you think that there is anything that the Commission has got wrong?

Heinz Zourek: This was done at very short notice; it was under heavy time pressure to come up with a proposal, so we could not have as thorough a debate with the market actors as we would usually like to have, to be honest. I will not hide from you that this took us by surprise, for two reasons. First, it is very rare for member states to ask the Commission to come up with a tax proposal. This astonished us. Secondly, I would have lost a lot, if I had made a bet, on whether it would be agreeable to have enhanced co-operation in the tax field. Frankly speaking, it is only the third such case overall. I would never have thought that it would be agreeable among member states to say, "Well, go ahead if you're so stupid". This is something on which we have been a little overtaken by the speed of the process. We have to conduct a thorough analysis and collection of information in parallel to this process. That is what we are doing, and that is why we are having constant meetings with those affected or interested parties. We like most to have meetings with those who hate the FTT, because we learn most from them.

The Chairman: Do you know the reason for the speed? What is the justification for it? Why not let us all have a go at getting it right?

Heinz Zourek: There are two reasons. First, it was the desire of Ministers of Finance to generate revenues to address their budget difficulties. Secondly, there was a huge uproar, saying that the financial institutions must not be allowed to bring us to our knees and then get away with murder. It was because of the strong popular outcry and the strong interest from Ministers of Finance to get some kind of compensation for the strain that the

resolution and the fight against the crisis has put on national budgets. That is what led us to do things at this speed. One international reason was that you could see a decline in global harmony or consensus on it, because the G20 was very outspoken, but then some of the BRICS said, "What financial crisis? It's yours". Then the Americans took a different way to resolve the crisis. So then they said, "If you're so stupid, go ahead".

Lord Kerr of Kinlochard: Presumably you would have much preferred to show everyone before the procedural decision in Council on 22 January what your new proposal would be. Some of the resentment results from the fact the Council was required to take the procedural decision on the assumption that the proposal that would emerge was the one that had been lying on the Council table. When something completely different emerged a few days afterwards, some people found it quite surprising. I am sure that, given more time, you would have preferred to have the sequence the other way around.

Heinz Zourek: No. For procedural reasons, I would like first to have a driving licence and then to embark on buying a car. This means the authorisation decision before I do it is always given as reassurance. The second reason is that the margin of manoeuvre for the Commission was very limited, because enhanced co-operation is based on the requests of Member States which wish to establish enhanced cooperation between themselves and they requested to broadly follow the original proposal. It was not possible to turn a proposal on a transaction tax into an activities tax.

Lord Kerr of Kinlochard: But you added a second defining principle—you changed the whole nature of the tax.

Heinz Zourek: No, we added one of the sub-sub-sub criteria, one thing that some of the member states and the European Parliament suggested, because it is already applied in a number of member states. We were not advocating it very strongly, but we took it up on the request of member states—and nobody would have prevented member states bringing it up in the Council working group as an amendment, or in the Parliament. We see that we have been criticised by some member states for sticking too closely to the original proposal and not taking the occasion to scrap the lot. The letter that we had from those that were interested said that they wanted enhanced co-operation on the basis exactly of the original Commission proposal. Reference was also made in particular to the need to avoid evasive actions, distortions and transfers to other jurisdictions.

Q12 The Chairman: Mr Zourek let us conclude there. It has been an absolutely fascinating exchange, and we have not even touched on the objectives of raising the tax—but you have, and you have given us several versions. We outlined in our original report that we were concerned that there was a variety of reasons for doing it; the one that you put at the top today was that there was a 40-year period in which to repay the disruption caused by the financial actors in all this. Can I ask you to supplement the report that we will get on those you have conversed with on this matter—and it is limited—in terms of those you have spoken to in the Treasury? We would find that enormously helpful. Can I be a little bit patronising? I have tried to deal with these matters in my native language of English, but the three of you have shown wonderful competence in dealing with very difficult and testing matters in English, and the Committee is extremely grateful. Sometimes we Brits do not acknowledge the linguistic skills that our colleagues here have—and I put that on record. Also I put on the record the candour with which you have spoken. We will go back and have a good think about what we have heard today, in dealing with these complex matters. Some of my colleagues who are experts in these matters have winkled out some very interesting points. I invoke the parliamentarian poet of the 17th century, John Milton, who in *Paradise*

Lost had a line to the effect of making darkness visible. This hour of exchange has made darkness visible in our case, and for that we are grateful. We conclude this session, and we look forward to receiving the reply that is being drafted over the next few days. Many thanks indeed.

Heinz Zourek: Thank you for coming. I have enjoyed this conversation very much, and I hope that you get a little insight into how we work and why we did things as we did.

Maras Sefcovic, Vice-President, European Commission, letter to the Chairman 31 October 2013

The Commission would like to thank the House of Lords for its Opinions of 30 July and 10 September 2013 concerning the Commission proposal for a Council Directive implementing Enhanced Cooperation in the area of Financial Transaction Tax (FTT) {COM(2013) 71 final}.

As indicated in the letter of 29 August 2013 of Commissioner Semeta, the Commission would like to come back on the issue of the possible collection of the FTT by the authorities of non- participating countries.

First, the Commission firmly believes that the proposal respects public international law and in particular territoriality principles, as it would provide sufficient connecting factors with the territory of the taxing Member State.

The basic collection mechanisms of the proposed tax have not been set out in the proposal, as this is considered a prime competence of the Member States under the proportionality and subsidiarity rules. The Commission however provided for the possibility for it to adopt implementing acts in respect of uniform methods of collection of the FTT due.

In order to assist Member States, the Commission services are reflecting on appropriate collection mechanisms. Collection through central financial market players (e.g. exchanges and clearing houses) is one of the possibilities to be analysed. Straightforward and simple solutions have to be sought for in the first place.

The proposal merely prescribes the competences, rights and obligations of the participating Member States in respect of a common system of the FTT In the absence of bilateral agreements and/or multilateral conventions with non-participating Member States and third countries, for example, exchanges and clearing houses situated outside the territory of the Member States participating in the enhanced cooperation in the area of the FTT can thus only be involved in the FTT collection on a voluntary basis.

However, as a safety measure the proposal provides for joint and several liability in case the (initial) person liable to pay the proposed tax (or someone for him) has not paid the FTT due in time. It is to be noted that this joint and several liability as provided for in Article 10(3) of the Proposal falls on a party to a taxable transaction for which - as mentioned - the Commission firmly believes that there are sufficient connecting factors with the territory of the taxing Member State. Furthermore, this provision on joint and several liability would constitute an incentive for parties to deal with tax compliant counterparties.

Distinct from tax collection mechanisms are procedures for the recovery of claims relating to taxes as legislated under Council Directive 2010124/EC to which the Opinion of the House of Lords refers. While the implementing acts of enhanced cooperation do not bind the non- participating Member States, enhanced cooperation cannot lead to the non-participating Member States disregarding provisions in other acts of the Union not covered by that enhanced cooperation, such as Directives 2010/24/EU and 2011/116/EU, because of an arguably remote relevance to provisions adopted within an enhanced cooperation.

Maras Sefcovic, Vice-President, European Commission, letter to the Chairman 31 October 2013

The principle of uniform application of EU law requires that provisions in these Directives be applied in their proper terms and in the same way throughout the Union. While proper application of these Directives may entail some minor administrative costs for Member States, it is not logical to claim that such costs are imposed by the Authorising Decision (or, following the same logic, by the Member State establishing the tax in relation to which mutual assistance is requested).

These instruments should be used under the limits and conditions set therein. As a rule, the usual national procedures need to have been exhausted In any event, the Commission does not believe that the use of these existing instruments of EU law for the FTT can be considered as 'additional costs' for the non-participating Member States, especially as, for instance, Article 20 of Directive 2010124/EC stipulates that "the requested authority shall seek to recover from the person concerned and retain the costs linked to the recovery that it incurred".

As already mentioned in the previous reply, the proposal is currently being discussed at the technical level in the Council where these issues are still at the centre of the debate.

Additionally, in reply to the Opinion of 10 September 2013, the Commission would like tore- iterate the view that the Council Decision authorising enhanced cooperation in the area of FTT has judged that such cooperation fully respects the competences, rights and obligations of non-participating Member States in accordance with Article 327 TFEU Furthermore, in future work the Commission will continue to safeguard the rights and competences of all Member States.

The Commission hopes that these additional comments clarify matters and looks forward to continuing our political dialogue. In this respect the services of Commissioner Semeta stand ready to meet with you at your earliest convenience.

31.10.13

Manfred Bergmann, Director of Indirect Taxation and Tax Administration, DG TAXUD, European Commission, John Vella, Oxford University Centre for Business Taxation, and Richard Woolhouse, CBI—Oral evidence (QQ 1-18) 19 March 2013

Evidence Session No. 1 *Heard in Public* *Questions 1 - 18*

TUESDAY 19 MARCH 2013

11 am

Members present

Lord Harrison (Chairman)
Viscount Brookeborough
Lord Dear
Lord Flight
Lord Hamilton of Epsom
Lord Jordan
Baroness Maddock
Lord Marlesford
Baroness Prosser
Lord Vallance of Tummel

Examination of Witnesses

Manfred Bergmann, Director of Indirect Taxation and Tax Administration, DG TAXUD, European Commission, **John Vella**, Senior Research Fellow, Oxford University Centre for Business Taxation, and **Richard Woolhouse**, Head of Tax and Fiscal Policy, CBI.

Q1 The Chairman: Colleagues, I begin this single session of the follow-up to our published report on the financial transaction tax with our very warm thanks to our witnesses, who are here before us today. Could I remind colleagues that when they first speak, they should declare any interest they have which might affect what they say? I remind our witnesses that a transcript will be made, as per usual, of this exchange. It will be sent to you and we ask for corrections. If there are any further ideas you have on which you care to elaborate, we would be most grateful. We are, as ever, webcast so please do speak up. We would be most grateful if you could do that.

My thanks to the first three but I am particularly grateful to the Minister, Greg Clark, who has been able to send Mr Roland Phillips from the Treasury. He is sitting at the back and he handles these matters in the Treasury. We will have a private session with Mr Phillips later, after the witnesses leave. Perhaps the witnesses, when they answer the first question which I

am shortly to propose to them, would like to introduce themselves by saying who they are and where they represent. That would be very helpful for us to start.

I wonder whether I could invite the three of you to say what your view is of the new proposal of enhanced co-operation on the financial transaction tax. I shall ask Mr Bergmann in particular to start off, but can I say how grateful I am to the Commission and to you, sir, for coming over this morning to help us out with this very tricky issue? Thank you to all three, but particularly to Mr Bergmann. Would you like to say a few things about yourself, Mr Bergmann, your position and your view of what this might achieve?

Manfred Bergmann: Thank you, Lord Chairman, for this invitation. I am also very pleased, as is the Commission, that you have given us this opportunity to provide you with some evidence on this, as it is very important. Myself, for two years I have been a director in the DG for Taxation and Customs Union. I am also in charge of co-operation on tax administration and director for the field of indirect taxation. As the financial transaction tax we are talking about is an indirect tax, that is why it has ended up in my department. It has been developed in my department with the help, of course, of other services of the Commission such as DG MARKT, the legal service and DG ECFIN, which have provided a lot of economic analysis as well. Commissioner Semeta could not come to this event. He was here last year on about the same day, more or less. I think it was 17 March at that time.

The proposal is in principle an answer to the request of 11 member states, who had asked to be allowed to go ahead with the co-ordination of financial transaction taxes in Europe, despite the fact that not all 27 wanted to go ahead. In principle, this initiative on enhanced co-operation is coming back to one of the basic root principles of the European integration process: that a smaller group of countries goes ahead and shows that it works, then others join. You might remember that in the 1950s it was six countries, with only a coal and steel union. When that worked, they expanded it to a customs union and things like that and by now we are 27 member states. The hope of the Commission is that this initiative of harmonising taxation on financial transactions will also be a first tangible step to a wider European and, at the end of the day, global solution. That is something we should not forget but, of course, these 11 have to show that it works. The proof of the pudding is in its eating, if I may say so. I would also like to remind you that the counterfactual to enhanced co-operation is not to have no FTT at all in Europe. The counterfactual would be, for example, 11 national solutions which are not co-ordinated.

The Chairman: Just before I go to the other two for their opening shots, could you confirm or otherwise say whether the objectives—of which we, in our original report, identified five from the Commission paper for setting up an FTT—remain in place? Is there a priority given to any particular one or two of them, for instance on improving the European Union budget or restricting unwelcome transactions? What would you say are the priorities now of the FTT, Mr Bergmann?

Manfred Bergmann: I think there are two priority goals. The first is actually the harmonisation of these taxes to avoid having the mushrooming of 27 different solutions. You go for harmonising indirect taxes so that you avoid occurrences of double taxation and double non-taxation. Our preference had been to have it in the EU-27; now we have only EU-11 but in future there might be more member states. The second priority objective is of course to have this tax as a revenue raiser, to get a fair and substantial contribution from the financial sector for covering the costs of the crisis, for which it has much responsibility—and, in principle, to apply the system of sound fiscal policy-making which says that those who benefit from a policy, such as bailing-out operations, should also be those who pay for it. The

bailing-out operations have cost about 15% of GDP - and a fair and substantial contribution, according to Commission estimates, is of about 0.5% of GDP. It would take about 30 years until the financial sector will have paid it back. Then, but only as a kind of secondary objective, we have the objective of discouraging activities which are not really enhancing efficiency. They are not really generating values but are often only redistributing values and wealth.

Q2 The Chairman: Mr Vella, introduce yourself please. What is your first reaction?

John Vella: My name is John Vella and I work at the Oxford University Centre for Business Taxation. In terms of my response to the 2013 proposal, in short, I am still not convinced that the adoption of the tax as proposed by the Commission is a good idea. I think the objectives and design of the tax largely follow those in the 2011 proposal. A number of concerns were raised about the 2011 proposal, which I do not believe have been met in a satisfactory way by the Commission. Broadly, I would say that there are still some concerns about some of the objectives. First, some of them are not clearly justified, in my view. Secondly, I believe that there could be better instruments to achieve those objectives, even if one accepted them. In short, I still do not think this is a good idea. There are other issues we could discuss such as the issuance principle and the effect on non-participating member states, et cetera, but I believe we will be discussing them later on today.

The Chairman: Mr Woolhouse, like Mr Vella you, too, have helped us out before. Can you help us today?

Richard Woolhouse: Thank you, Lord Chairman. I am Richard Woolhouse, head of tax and fiscal policy at the CBI. We represent the business community in the UK. I would say that our views have not changed dramatically since we last gave evidence to you. We still think that, at the moment, the priority should be encouraging economic growth. Particularly in Europe, you have seen the backdrop deteriorate significantly over the last year and a half. We think that this proposal will damage growth and that, either directly or indirectly, the cost will be borne by the business sector through a higher cost of capital or by savers via a lower rate of return. We do not think that the FTT supports the financial reform programme in any meaningful way. There is a lot of academic debate about that. I think most of it seems to suggest that the impact of an FTT on liquidity in markets would largely be damaging.

Finally, we do not accept the arguments that the financial sector is significantly undertaxed as being convincing. We could go on to talk about some of those issues. I would stress that this idea that "We want to get our money back from the financial sector" seems to be underlining a lot of the objectives of this. The point is that the incidence of this tax will not be borne necessarily by financial intermediaries. It will be the end users of those financial products who will bear the tax.

Q3 The Chairman: Mr Bergmann, when the Commissioner came before us on St Patrick's Day last year, there was much criticism or highlighting of the impact assessment that the Commission itself had done. The follow-up to that, as I understand it, does not highlight much the possible impact on non-participating European Union member states. I wonder whether you might say a little about that. Greg Clark, the Financial Secretary to the Treasury, who came before the parent Select Committee last week, highlighted that, too. He said that we have not had an adequate assessment of the proposed impacts on non-participating member states. Why has the Commission perhaps neglected consideration and

thought for those member states which are in the preponderance, and which will not form part of the 11?

Manfred Bergmann: I would contest that the Commission is neglecting this issue. If you read our new or additional impact assessment, one has to read it together with what we have already produced. What we produced beforehand was an analysis for the 27 member states. The so-called negative impacts which were quite frequently quoted were quoted out of context. For example, there is this famous or notorious 1.74% decline in GDP over 40 years. That was quoting from a model simulation which was not a simulation of the tax that the Commission had proposed, because the model could not at that time cater for this kind of world. In between, the Commission had undertaken additional analysis—I think our Commissioner at the time had already indicated the first tentative results, which were afterwards confirmed—that there was an impact on GDP, cumulative over 40 years, of about -0.2% or -0.3%, when you do not take into account the clever recycling of this money. If you take into account intelligent recycling of the money, the "impact" might even be slightly positive.

When we analyse the initiative of the EU-11 only, the question we were looking at was: "Are there now additional mechanisms playing here?" As you rightly said, initially the models always work with the assumption that the FTT will lead to an increase in the cost of capital. Lower share prices, will lead to lower investment and, as a result of that, you have lower growth and lower employment. As a result of harmonising now for only 11 instead of 27, there are no new mechanisms coming into place. At least, we could not find any additional economic mechanism based on which we would have said, "This is new and could have positive or negative impacts".

The new impact assessment is also model-based. It takes the same model and the results are the same, which means that we have a small increase in the cost of capital for the EU-11. And there is a much smaller increase in the cost of capital for those who are not participating, because after all they are not introducing this tax. The effect on the non-participating countries is even smaller because there is hardly any tax.

The backside of this coin, of course, is that there is also no recycling of tax revenues in these countries. Only the EU-11—the participating member states—generate additional revenue. As a result of this they can also recycle it and put it into productivity - "enhancing investment", consolidating public finances or whatever they would like to do. We do not see negative effects from this analysis on the non-participating member states, and especially no negative impacts on the City of London. You might also recall that when France introduced its own stamp duty, Mr Osborne or Mr Cameron—I do not know which—said, "We will roll out a red carpet for all the investors and bankers who would like to relocate to the City of London". We cannot assume that there will be a negative impact on the non-participating countries.

The Chairman: It was an obscure man called Boris Johnson, I think. Lord Jordan, would you explore this?

Q4 Lord Jordan: You are playing down the impact on the UK financial sector, which is one of the biggest in the world—if not the biggest. However, you have made no definitive statement on what that impact will be. The City of London is not going to participate in it. However, because you have introduced this tax they are entitled to know how it is going to affect them, and affect them it will. Have you done any exercise at all to show clearly what the financial impact of this new tax will be on the City of London, and would the UK firms

or the UK tax authorities be forced to bear the cost of collecting the tax on behalf of participating Governments?

The Chairman: Let us try on the impact issue with Mr Woolhouse first, then Mr Vella and then come to you, Mr Bergmann.

Richard Woolhouse: The point to note is that the original proposal and now the new proposal, even more so, essentially involve a large element of extraterritoriality. Many activities currently taking place in the City of London will be captured, as you rightly point out, not only with respect to entities transacting with financial institutions in the zone but now in transacting securities that have been issued in the zone.

Lord Flight: It is the other side as well.

Richard Woolhouse: That is certainly something which is unprecedented in terms of normal international tax practice and it is clearly at the heart of the issue. We have not done any work on trying to assess how this will impact the City of London and I have not seen a lot of detailed work done by others. It is a very complicated issue. There are potential impacts from the fact that you are going to have a damaging impact on growth and the amount of financial activity in Europe overall. There will also clearly be substitution impacts within. I have not seen any information about that.

In terms of the collection of the tax, the proposal is not clear. The large financial institutions will clearly have systems in place to monitor this. There are questions about intermediaries knowing the end residence and tax status of their customers. There are also issues with respect to transactions of derivatives, where no money may be exchanged at the point of original contract and there are therefore questions about how that is followed up. The final point to note is that this ranges across such a range of assets and activities that it is not going to be easy either to monitor or police how collection is occurring.

The Chairman: Before I bring Lord Flight in would you, Mr Vella, answer Lord Jordan's point about the work that has been done on the impact assessment?

John Vella: The immediate answer is that you are right about the impact assessment. When I opened it, I was expecting to find a section there that comprehensively detailed the impact on non-participating member states. As Mr Bergmann was rightly saying, there will be some positive impacts and some negative ones but we do not find a comprehensive assessment of them. All we find are bits and pieces of information here and there. One other point I would like to make about the information on the effect on non-participating member states is the following. I would have expected the Commission to produce this information and provide it to non-participating member states before the vote was taken in Council as to whether a small group of member states would be allowed to go ahead with this proposal to use the enhance co-operation procedure. Without having this information, member states could not have made an informed decision as to whether to allow a subset of member states to go ahead with it.

The Chairman: Before Mr Bergmann comes back in, Lord Flight—

Q5 Lord Flight: There is an important technical point here. Is the extraterritorial application only as one would expect, for example to a German or French-registered business that is trading in London? What about the UK subsidiaries of such businesses, which are not French or German companies, but where that is mostly how they will be structured if they are doing business in London? I cannot see that the extraterritorial issue could apply

to, say, Deutsche Bank UK, which obviously could be set up for the purpose anyway. What is the technical position on the extraterritoriality? I believe it would not work anyway, for the reason I have just given.

Manfred Bergmann: We have not found any additional economic mechanism to say that this is something new which we had not analysed before and which could potentially be damaging for the non-participating member states. There was nothing extra on relocation, for example. There was nothing extra on imposing a burden on them. There was nothing extra on the increased cost of capital or things like that. We looked at different potential mechanisms and found nothing which was special, let me say, for non-participating members as opposed to the participating ones. In our initial impact assessment, we already showed that the impact is rather small in principle and negligible in the long run.

The question of the collection of the tax is something different. For example, on the question of in how far the UK or the City of London could be forced by the participating member states to collect the tax on their behalf? Of course not! Legal acts adopted under the procedure of enhanced co-operation would bind only those member states that are participating in this. They are not binding on those who are not participating in it. From that point of view, there is no extra burden on the non-participating member states to collect the tax on things like this. On collection, we have remained rather silent so far because it might not be necessary to harmonise it. Of course, it might be wise to harmonise it—it might be beneficial if one harmonised. But the proposal is about harmonising the design of a tax so that we do not have double taxation and double non-taxation. From that point of view, there is no risk that the City of London will be negatively affected by this.

On the question of subsidiaries, as a professional economist I would say: it depends on what their business is. As set out in our proposal, at least one party must be deemed to be established in the FTT jurisdiction. If the subsidiary is undertaking business which has no economic link to the territory of participating member states, no tax is due. However, if a subsidiary acts, for example, in the name and for the account of its headquarters then of course it is deemed to be established where the headquarters are. We also have our Article 10.2, saying that only the last in the chain of the transaction has to pay the tax. If the subsidiary acts in the name of the headquarters, the subsidiary does not have to pay the tax. It would actually be the German headquarters that would have to pay it.

The Chairman: I am going to bring in Lord Dear but Lord Vallance exhibited some surprise and I do not know whether he wanted to follow up that point.

Lord Vallance of Tummel: It was not so much surprise as perhaps a lack of understanding of what you were saying. Maybe I misunderstood, but I think you said at one point that there would be no obligation for these taxes to be raised in the UK. Is that what you said? You might want to revise that but in other words if there were a transaction, one leg of which was in the UK, there would be no obligation for the UK to raise a tax on that transaction.

Manfred Bergmann: That is right! The UK does not have to raise a tax on that transaction. Member states who are participating might want to raise a tax on the transaction because it has an economic link to their territory. Let me say that the situation would be similar to the UK stamp duty, for example, which has to be paid by non-UK residents. It has to be paid by German and French banks and by German and Japanese investors, as soon as they purchase a UK share. In the UK stamp duty it is only on one side, the buyer. One could say, "that you have a bias against buyer, while the Commission has proposed to share the burden between

the seller and buyer"—between the two parties in the transaction. But once again, the UK stamp duty does not mean that the German Government has to collect that duty. It is after all the UK Government who does that, with the help of Crest. German and other Governments might want to do it with the help of the different systems in their FTT-zone. They might want to invite the City of London or Wall Street to help them in that, but it is on a purely voluntary basis.

Q6 Lord Dear: Thank you very much for that, Mr Bergmann. I was going to ask Mr Vella and Mr Woolhouse whether they felt that they had enough information to make an assessment of the merits of this but I am hearing something for the first time, as I think my colleagues are as well—in other words, that the City of London could well be excluded from this. Perhaps I could take my question of whether you have enough factual information to come up with a view on the merits of the case and ask: in the light of what we have just heard, how do you feel now?

John Vella: We have some information but we have quite significant gaps in our knowledge. That would be my short answer. There are gaps in our knowledge in terms of some of the detail of how this would impact participating and non-participating member states, and even about some of the broader principles. For example, as we heard, while one of the objectives is to reduce transactions that do not enhance the efficiency of financial markets, as the Commission itself recognises, the empirical evidence of the effect of high-frequency trading on market efficiency is still inconclusive. This is to say that we still have gaps in our knowledge as to the broad, important questions that this tax raises.

To go back to the discussion we were having about the impact on the UK, of course there will be an impact. Financial institutions in the UK will be subject to the tax; if there is a reduction in activity we could have a reduction in taxes collected in the UK, et cetera. Actually, there could be a reduction in tax collected in the UK even if there is no reduction in activity. So there will be both negative and some positive impacts. As I said, the Commission does not comprehensively set out what these positive and negative impacts will be.

Lord Dear: Without appearing rude and interrupting, from what you heard from Mr Bergmann this morning, have any of your previous views been caused to change?

John Vella: No. There are bits of information in the impact assessment of 2013 which say that there will be some double taxation, that the tax will be borne by financial institutions outside the participating member states, such as UK financial institutions, and that there might be a small increase in the cost of capital for UK corporates. There are these bits and pieces of information but they are not really elaborated on.

I have one final point about the information in the impact assessment of 2013. A number of calculations in the 2013 impact assessment appear to me to be extremely rough. They seem to be back-of-the-envelope kind of calculations. For example, the impact of the issuance principle is dealt with very roughly. On the impact of double taxation, the impact assessment says: "There is going to be some double taxation. We don't think there is going to be much", but that is it. To be fair to the Commission, one must recognise that there are difficulties in estimating the size of these problems, but I think that it could have undertaken more serious research into the extent of this.

Richard Woolhouse: I agree with all of that. The question I am interested in going back to is that of the residence principle.

Lord Dear: Sorry, the residence principle?

Richard Woolhouse: Yes. My understanding, prior to what I just heard, was that the derivatives trading activities of Deutsche Bank, BNP Paribas et cetera in London would be captured because they would be inside the zone. You talked about issuance in the context of stamp duty but, to go back to Lord Flight's original question, I am slightly confused about the activities of FTT member companies with subsidiaries in London undertaking activities there but which are not necessarily associated with German corporates. Would those be captured or not?

The Chairman: Would you like to answer, Mr Bergmann?

Manfred Bergmann: Yes, sure. Of course they will be captured! To avoid a misunderstanding, the question was in how far the City of London or the UK would be forced to help Germany, France and Italy to collect the tax, and there I said "no, they will not!". They will not at all be forced because all legal acts adopted under enhanced co-operation bind only participating member states! Neither can these acts change existing EU legislation. That is why we have had to modify our initial proposal, because initially we proposed some minor adjustments to the capital duties directive, which is not possible under enhanced co-operation. It can only be about a new policy here—this harmonisation in the field of indirect taxation. There is no obligation whatever on non-participating member states of whatever kind as a result of legal acts on enhanced co-operation! It is up to Germany, to France, to Italy or to Spain to get the tax from this transaction.

That is why we have, for example, foreseen joint and several liability. If the UK side does not want to pay then the German side might have to pay twice the tax, as an illustration. If it always ends up like this, at a certain point in time the German side might want to factor that into its prices or say, "Okay, my counterparties never pay the tax and I always have to take it over, so I do not enter into deals with them any longer", but there is no obligation as a result of enhanced co-operation on this.

The Chairman: Lord Vallance, would you take us a bit further on the residence and issuance principles which have developed?

Q7 Lord Vallance of Tummel: I will try. One of the major changes between this proposal and the prior one is the introduction of the issuance principle as well as the residence principle. As I understood it, the issuance principle provides that financial instruments which have been issued or originated in a participating state may be taxed whenever and wherever they are traded in the future, even if neither party to such a trade is based in the participating state. The example was that a Volkswagen share traded between banks in London and New York would be charged. Is that correct?

Manfred Bergmann: Yes.

Lord Vallance of Tummel: Can you give us your interpretation of the value of the issuance principle? Why was it brought in? Is the idea to block the potential relocation of transactions from one market to another?

Manfred Bergmann: There are different ideas behind this but from the Commission side, this is the key idea. We should step back and recall first that the European Parliament asked, in May last year, to strengthen the anti-relocation provisions of the Commission proposal by adding the elements of the issuance principle to the residence principle in the way we have done it. On top of this, the Parliament also asked to go for some kind of lack of legal enforceability of a contract in case you do not pay the tax. That is what we have not done.

If we have the tax as the Commission has proposed it, the issuance criterion is coming in only as the seventh criterion. At first, there is a check on whether there was an authorisation, where the headquarters are located and things like that. Each time when one of these criteria is activated, we stop checking as the tax is due where that criterion had been activated. Only as the seventh criterion, when none of the first six criteria were saying that this is a taxable event, does the trading in products issued in the FTT jurisdiction come in. According to our impact assessment, this might cover an additional 3% to 4%. All the other 95% of the transactions will already be taxed due to other criteria. This was one narrative behind this.

The other narrative behind this is that we have to talk about the primary redistribution of revenues. This Article 4, which defines the residence principle and the issuance principle, defines also to which country the money accrues. You might know that France, for example, and Italy as well, have recently introduced a kind of "FTT-minus" or "stamp duty-plus", which is mainly based on the issuance principle. It could indeed happen that in the negotiations, member states will say, "We would like to change the order of the criteria and put, for example, the issuance principle at the top". At first, what would be checked was whether the product had been issued in one of the participating countries. If it has been issued there, independent of the party, then the tax would accrue to the country in which the product had been issued—like the UK stamp duty being on British shares, full stop.

Lord Vallance of Tummel: Can we just take this concrete example which was given to us of this Volkswagen share which is traded between banks in London and New York? Where would the tax be raised, and how?

Manfred Bergmann: Those are two different questions. The issue, of course, is that the tax would have to accrue to Germany because it is a German share. The second question is how to collect it. On that we are also looking, for example, at how you do it in the UK with your stamp duty because, after all, the purchase of a British share is taxable wherever it occurs. You have the Crest system, which helps you a little. Participating member states will have to find solutions on how to tax this. They will have to agree on solutions in any case on how to collect the tax but this is the next step. We are still in the phase where we want to design the tax. The next step is how to then collect the tax and the third is how to spend the collected tax.

Q8 The Chairman: In our original report, we said that the Commission might well spend time looking at the stamp duty model. I want to turn to Mr Woolhouse and Mr Vella on that question of the issuance and residence principle. I wonder if the two of you would also sweep up Mr Vella's comment that there could be positive impacts for the United Kingdom. I think that Mr Woolhouse agreed with that. Could you just tackle the issuance and residence principle, then say whether there are any that you perceive?

John Vella: There are a few things that one could say about the issuance principle. First, as Mr Bergmann is rightly saying, the Commission is presenting this primarily as an anti-avoidance measure but the thing to keep in mind is that it goes way behind its anti-avoidance purpose. As a result of the issuance principle, if a German bank had to sell a share in a German company to a French bank, it would not be able to avoid the tax by doing it through their UK subsidiaries. To this extent, it prevents avoidance but the issuance principle goes beyond this: if a UK pension fund had to purchase shares in a German company from a US bank, it would be caught. You can see that this kind of case is caught but it was not a

problem with avoidance of the residence principle, so the first point to make is that it goes beyond the justification of being an anti-abuse provision.

The second point to make is that while it is true that the UK stamp duty adopts the issuance principle, that duty is much narrower. It applies to a much narrower set of financial instruments, so here we are talking about the issuance principle being used in an unprecedented way.

The third point to make is that if one looks at page 40 of the impact assessment, one finds a bit of analysis as to what impact this issuance principle will have but, as I said, unfortunately I believe that this analysis is based on very rough calculations. It is hard to analyse this properly but I think they could have done better than this.

The final point to make is a tough one. There are concerns about the compliance of the issuance principle, and even the residence principle, with principles of customary international law, which requires the territory that is imposing the tax to have a genuine link between itself and the object, property or transaction being taxed. There are questions as to the extent to which the issuance principle complies with this principle of customary international law. Of course, the major counterargument to that is that if the UK stamp duty, which uses the issuance principle, is accepted as complying with customary international law, how can the issuance principle in this case not comply with it? The argument there would be that to determine whether a tax has a genuine link with the territory one has to look at the objective of the tax. The objective of the UK stamp duty is different to that of the financial transaction tax, which allows us to say that this comparison is not fully justified. I have just finished an academic article with two co-authors, Professor Joachim Englisch from the University of Műnster in Germany and Anzhela Yevgenyeva from Oxford. We dealt with this issue at great length, so if your Lordships would like me to pass that on I would be happy to do so.

The Chairman: Mr Vella, we would be most grateful anyway to the three of you if there was further information that you wished to forward to us. Before I bring in Mr Woolhouse, Lord Vallance.

Q9 Lord Vallance of Tummel: Let us suppose that we have a German company that is listed on the New York Stock Exchange through American depository receipts—ADRs. Would they be caught by the issuance principle or not, even though they were in effect issued by the New York Stock Exchange in America?

Manfred Bergmann: Yes, we have our special anti-abuse provision where we say, especially on treating depository receipts, that when the business model is to avoid the tax then the issuing of such depository receipts would be deemed to be issued there, where the underlying asset has been issued. If it is a German share which is going into the depository receipt, which then issues shares of its own which mimic to 100% the German share, this share of the depository receipt is deemed to be established there, in Germany.

The Chairman: Now, Mr Woolhouse, pick your way through that. Do not forget—this is to Mr Vella as well—that I did ask about your comment that there could be a positive result for the United Kingdom. Perhaps you could give us an illustration.

Richard Woolhouse: I think the positive result is that there will be substitution between those institutions which are captured and those that are not—

The Chairman: Which is what Boris Johnson said.

Richard Woolhouse: —and that that, in and of itself, will not have a net negative impact within the City. But there will be an overall impact on the bigger picture of growth and activity in Europe. That is a subsidiary point. I would re-emphasise a couple of points. On stamp duty, that is much more limited. I have seen a very interesting piece of empirical work which suggests that the costs of collecting £1 of stamp duty are 2 basis points. The cost of collecting £1 of all other taxes, when averaged out, is 111 basis points so the actual, practical effect of stamp duty collection is very limited. There is no cascading and it is exempt on transfers of ADRs, so stamp duty is a much more narrowly defined tax.

For the other point I would make, I would like to quote from a letter that I have here from a collection of American trade bodies, the American Chamber of Commerce and the Securities Industry and Financial Markets Association: "These novel and unilateral theories of tax jurisdiction are both unprecedented and inconsistent with existing norms of international tax law and long-standing treaty commitments". The letter goes on to talk about a number of other issues but I would make that point again to back up Mr Vella's point that there are significant questions here about the international tax law.

The Chairman: Mr Woolhouse, would it be possible to share that letter, and the source of the 2 basis points versus the 111? That would be very helpful.

Richard Woolhouse: Absolutely, yes. I can do that.

Q10 The Chairman: Mr Vella, was there an additional point to Mr Woolhouse's about the possible advantage to the UK?

John Vella: As I said, trying to figure out what the impact of the tax would be on non-participating member states is quite difficult but we can think that there might be some positive effects. Obviously, if we are saying that as a result of the tax there might be some relocation of activities and, indeed, entities or even capital from participating member states, the other side of that is that somebody has to benefit from that relocation. To give you a simple example, let us take a German bank which has two types of customers: UK corporates and German corporates. The tax will work in this way. If the German bank transacts with its German clients, it would be subject to the tax and if it transacts with its UK clients, it would be subject to the tax. If, however, the German bank creates a subsidiary in the UK and transacts with UK clients through the subsidiary, that is not subject to the tax. Indeed, it will not be subject to the tax when it transacts with entities from all over the world, other than those in Germany or in other participating member states. If it transacts with, say, New York or Hong Kong—all those entities—there is a clear advantage for the German bank to use its UK subsidiary to trade with the rest of the world.

The second point to make is that there might even be some benefit for the German bank to transact even with its German clients through its UK subsidiary, for the following reason. While a primary transaction would be caught by the tax, ancillary transactions might not be caught by the tax if they are carried out with, say, UK counterparties. Let us say that we have a financial transaction between the UK subsidiary of the German bank and the German customer and that the bank then wants to hedge against that. If it hedges using UK counterparties, it will not be subject to the tax, so there might even be some benefit in using the UK subsidiary to trade with German counterparties.

Q11 The Chairman: Before I go on to Baroness Prosser, whose question I think is highly pertinent, is there anything that you, Mr Bergmann, would want to respond to in that analysis by Messrs Vella and Woolhouse?

Manfred Bergmann: If you give me the opportunity, I will of course do that. On the collection cost, as I said, the Commission has so far remained silent because it is up to subsidiarity how these 11 want to collect the tax. However, when the Commission was asked what kind of system should be put in place, we, of course, have something in mind. It would come close to how the UK collect the stamp duty—using existing market infrastructures and trading platforms and go for all kinds of electronic transactions for collection, withholding the tax at the source, like a payroll tax. At the end of the day, the collection cost of the tax will be more in line with those 1 or 2 basis points, not the 111 basis points, if member states went along this way. If they do not go along this way and want to go for something different and more costly, that is their choice. Let us see what the process will end up with.

With respect to the potential relocation effects, according to the proposal tabled by the Commission, it depends on **who** is interacting with **whom**, on **what** product and in **whose** name, and for the account of **whom**. There are a lot of "W"s that need to be answered. As soon as one of these "W"s gets the reply "FTT jurisdiction" we are in the realm of a taxable event, unless the participating parties can prove that there is no link between the economic substance of the transaction and the territory of a member state in the FTT jurisdiction.

It might indeed be that there will be small issues and occurrences of relocation, but that is the price that one has to pay for the fact that one wants to introduce something at the regional level which would be best introduced at the global level. I think there is consensus in this room that an FTT should best be introduced at the global level, but obviously a lot of people—a lot of parties and a lot of countries—do not dare to go for it. Now this group of 11 is going ahead, and hopefully it can show that it works. When it shows that it works, then the others might say, "It is an interesting exercise. We would like to apply it as well".

The Chairman: But *a fortiori*, if you go from 27 to 11, that in turn weakens the possible ability for the FTT to operate.

Lord Marlesford: I want to ask a subsidiary question to what we have just been discussing—a simple one really. It is just to confirm my deduction from what has been said so far. If we take the three main financial centres of the world—London, New York and Hong Kong—they are not affected differentially in any way by the introduction of an FTT by the 11. Is that correct?

Manfred Bergmann: That is correct.

Q12 Baroness Prosser: There has already been mention made of the enhanced co-operation requirements. Just to remind ourselves, enhanced co-operation under the terms of the relevant treaty requires that it "shall not undermine the internal market or economic, social and territorial cohesion. It shall not constitute a barrier to or discrimination in trade … nor … distort competition between them"—that is, the countries. It "shall respect the competences, rights and obligations of those Member States which do not participate". In your view—each of you would probably have a view on this—does the financial transaction tax meet the criteria for enhanced co-operation? If not, what do you think would be the consequences?

The Chairman: Mr Woolhouse?

Richard Woolhouse: I was hoping you would not ask me that first!

The Chairman: Mr Vella, would you like to try that?

John Vella: Again, we dealt with this extensively in the paper I just mentioned, so I will send you that. The easiest one to deal with is the distortion of competition. I think it is fairly clear that the introduction of the FTT will introduce new distortions of competition. Just to give you one example, if a German bank is competing with a UK bank for business with a UK customer, after the introduction of the FTT the German bank will be subject to the tax while the UK bank will not, so the German bank will be at a competitive disadvantage as a result of this tax. We will have new distortions of competition and, in fact, we are going to have new cases of double taxation, as the Commission itself rightly recognises.

Within the group of participating member states, it is true that the FTT will remove distortions of competition but we have to look at the internal market as a whole, and when you do that the picture changes because we are going to have all these distortions of competition being introduced. Having said that, if the question was put to the Court of Justice of the European Union as to whether the proposal complies with Article 326 of the Treaty on the Functioning of the European Union, and therefore whether the proposal complies with the requirements of enhanced co-operation, it is not clear what response the Court of Justice would give. That is because the Court of Justice could adopt a very narrow approach to the judicial review of such criteria.

The problem is that enhanced co-operation has been used only twice before and it has been challenged only once. Italy and Spain challenged the use of enhanced co-operation in the patents area and thus far we do not have the decision of the Court of Justice. All we have is the opinion of the Advocate-General, in which he suggested that the Court of Justice should adopt a very narrow judicial review of such questions. We have to wait and see.

Q13 The Chairman: Any comments on that, Mr Bergmann?

Manfred Bergmann: As you can imagine, the Commission does not think that this will, in whatever tiny form, jeopardise the internal market, create discrimination or distort competition. We checked this before we tabled a proposal to the Council to authorise enhanced co-operation.

One has to distinguish here between introducing a tax and harmonising taxes. Enhanced co-operation is about harmonising an FTT among these 11. It is not about introducing a new tax. I said at the beginning that the counterfactual to go for an FTT via the route of enhanced co-operation within the realm of European integration, as foreseen in the treaties, would have been a plethora of national taxes which are not co-ordinated or harmonised, and which might even lead within the FTT zone, or within this group of 11 countries, to occurrences of double taxation and double non-taxation. We are talking here about harmonising a tax, not introducing a tax. However, the fact that we are harmonising the tax enables these 11 member states to have a somewhat broader tax base and, perhaps, to catch some of the more mobile tax bases which they might not have been able to do if they had not harmonised this. According to our analysis, this enhanced co-operation leads to a strengthening of the single market, because it avoids problems within the FTT jurisdiction.

By definition, for as long as not all member states participate, there is always a risk of double taxation because as I said earlier on, non-participating member states are not bound by the legislative acts adopted under enhanced co-operation. They can introduce an FTT or abolish an FTT. They can do whatever they want, as long as it complies with EU treaties. So by definition for as long as not all 27 participate there is a risk of double taxation. So far it is limited because only the UK has, for example, a stamp duty, which is only on the purchase of UK shares—it is not about trading in bonds or derivatives. You have your fiscal intermediary

relief, which we do not have, so you have a rather tiny tax. The occurrences of double taxation are rather limited at present. They might increase once member states say, "We would also like to go for a broader based tax, not within the enhanced co-operation process but on our own". That is the risk, or the result, of them not participating here.

The Chairman: Colleagues, we are lacking time. Baroness Maddock, would you ask your question and Lord Hamilton, would you immediately follow with yours?

Q14 Baroness Maddock: Good morning. I wanted to ask about how you see the effect on economic growth in the European Union. Mr Woolhouse mentioned this briefly in his opening comments. Also, when answering, I would be very interested to know how you see this affecting small businesses. One of the features of the economic crisis has been the fact that credit has not been very available. Do you see the introduction of a financial transaction tax further affecting access to credit?

The effects in France and Italy of their introductions of the financial transaction tax have also been brought to our attention. I understand that in France, the shares of smaller firms were particularly badly hit. I would be interested in your views on that. Also, I have here an article from the *Financial Times* about what happened in Italy, and the headline is: "Italian stock trading falls in the wake of transaction tax".

Lord Hamilton of Epsom: I have one additional question for Mr Vella and Mr Woolhouse. Do you think this financial transaction tax is ever going to happen? My next, proper question is about relocation and what the effect is on the EU's financial sector. Do you think that companies are going to relocate outside this area, possibly not even in the non-participating states? I wonder whether this is going to give an enormous fillip to tax havens. Will Bermuda, say, be setting up funds into which a German institution could pay one financial tax on the way in and from thereon pay no financial tax at all, as long as it avoids rigorously investing in any eurozone stocks?

The Chairman: Now, Mr Woolhouse—small businesses, that is your business.

Richard Woolhouse: Despite trying to pass the buck on enhanced co-operation, can I just make one or two very brief comments? I am quite surprised by the statement that there is absolutely no competitive impact. I am really sorry but I find that quite remarkable. I am not entirely sure that we at the CBI would want to argue for a purist perspective on harmonisation and the impact on the single market. In terms of enhanced co-operation, it is very important that we remain focused on getting the least damaging outcome for this process and that the UK remains engaged in the process and involved in the negotiations.

I think the point made about "We are not introducing any new taxes here" is, again, slightly difficult for me to take. If we take a view of the last couple of years, the French, Spanish and Italian FTTs would not have happened were we not discussing this a number of years ago. I would just make that point too.

On the impact on the economy, we have talked about this before in terms of the original impact assessments and studies. I have not seen any additional work with respect to SMEs. I suspect a lot of that is to do with liquidity in those markets, where you would have a disproportionately large impact on liquidity in those areas. In terms of the specifics of SMEs, you would have to look at the detail of the corporate exemption. SMEs would be exempt in terms of direct issuance; there is a secondary question about the impact on liquidity in those markets. Just to pick up that point, there is a lot of uncertainty about the corporate

exemption in terms of treasury functions and risk management activities within larger corporates, which I still think we need to note. Am I going to answer all of these questions?

The Chairman: Please do.

Richard Woolhouse: Do I think this is ever going to happen? My view on that is changing, and I am more concerned that this will happen, and I am very worried about what that might mean. That has been something that has been a recent evolution. We are obviously in slightly uncharted territory here, with respect to enhanced co-operation. I just make another point: when I talk to the people who are tax directors of large banks, they find it absolutely remarkable to suggest that this is going to be introduced on 1 January 2014. The systems changes that would be required are enormous and have not begun in any way, shape or form to be implemented in terms of the non-FTT areas. So I still have a lot of questions about the practicalities of introducing this with such a fast timetable.

Relocation and the impact of the financial sector—I think we have already covered some of that in terms of subsidiaries of FTT-zone banks to some extent. I would just make the point—I am slightly pre-empting a potential further question—that I do not think the Americans are ever going to introduce this. You are really very unrealistic if you think that there is some sort of wonderful demonstration effect here from introducing this tax. The stamp duty in the UK exists; it is very narrow; it has been around a long time; it is very well administered. The Swedes tried to introduce a financial transaction tax in the early 1990s which did not work at all. It will be interesting to see whether it does work, but even if it does work I think it very unlikely that the Americans are going to agree to this. In fact, I think the Americans will see this as a threat, not only for the extraterritorial implications from an international tax perspective but it has implications for the US-EU trade deal as well. I find it quite remarkable that we think that this is going to lead us down the path of enlightenment and we will all want to introduce this at a global level.

Lord Hamilton of Epsom: And tax havens?

Richard Woolhouse: As it is founded—we discussed this earlier—you do not need to have that happen through tax havens. It will happen through New York, London and Hong Kong.

Lord Flight: Ireland.

Richard Woolhouse: Yes.

Q15 The Chairman: Mr Vella, could you tackle Baroness Maddock's questions and Lord Hamilton's array of questions, and then I am going to tell the Committee what I am going to do to finish off this part.

John Vella: So, in terms of the effect on growth, we know the FTT will have a negative impact on growth, because it will increase the cost of capital, reduce investment and all the subsequent effects. The question is "By how much?" Now, the Commission used a general equilibrium model in its first impact assessment to estimate this effect, and then it changed some assumptions which led it to revise the estimate downwards. There are two points to be made here. First of all, of course it is legitimate to use these models, but we know they have significant issues. When mentioning the figures produced by these models, we have to keep in mind that we do know they have these issues. The second point is that, even if we go along with these models, a number of concerns have been raised with respect to the model used by the Commission. For example, in two papers by Oxera, the economics think tank, they lay out a set of concerns—so, for example, when seeing the effect of the tax, the

Commission's model only looks at the tax on securities. It does not look at a tax on derivatives. The model is a closed economy model, so it does not take into account relocation effects. So there are a number of issues. The Commission, in its new impact assessment, cited the papers which made the criticism, but as far as I could tell it did not address them.

One final point on growth: at times, the argument is made that we also have to take into account the positive effect of the spending of the revenues generated by the FTT. If the revenues raised by the FTT are spent in a way that leads to growth, that tells us something about the positive effect of spending. It does not tell us anything about the effect of the tax on growth. So the spending could have been carried out with money raised in any way.

Q16 The Chairman: Colleagues, because I wanted to make room for a comment from the Treasury—from Mr Phillips—I am going to ask the indulgence of our final four colleagues just to table their questions now. Then I am going to address the witnesses about how they might be replied to.

Lord Flight: The Commission originally had the vision of an international FTT, and that it would only work if that were moved towards. I cannot think that unless the US co-operates that even a limited 11-out-of-27-EU FTT is workable. I cannot imagine the US collecting a tax on behalf of Germany when two Americans are buying and selling a depository receipt in Daimler in New York. The Americans would tell you that the legal jurisdiction is US and it is contrary to treaty, and there may be some elements of that in the UK as well.

Viscount Brookeborough: Mr Bergmann, Commissioner Semeta said that this might dissuade people and "temper irresponsible trading". How would you define that? I am not quite sure that I see how adding a tax to it will deter people from doing it.

Just one question for Mr Woolhouse: I think you said that there is really no work being done on most of this—you said this early on—as far as it affects the United Kingdom and so on. Whose responsibility is it? Who has been asleep, and why has it not been done? Is it the Government, is it the City or is it yourselves?

Lord Marlesford: We have heard from Mr Woolhouse that stamp duty costs 1 basis point ultimately to collect, and that the administrative cost of the FTT is 100 basis points plus, I think it was. Given that, and given the huge complexity which has been revealed in this most interesting discussion, would it not be sensible for the Commission to have a look at something much simpler such as stamp duty, rather than persist with something that seems to have found so little favour in the three great international financial centres of the world?

Lord Vallance of Tummel: My questions are on the use of the tax once raised. It has been suggested that it could be used as an own resource for the EU budget, to reduce the gross national income contributions of participating member states, and that it might be channelled into growth-enhancing projects. Could you shed any light on that? Specifically, from the point of view of the UK, HM Treasury have told us that any use of the FTT as an own resource "will not impact on non-participating Member States and will not impact the calculation of the United Kingdom correction". Is that right?

Q17 The Chairman: I do apologise to the three of you that we have not got time to answer all the questions. We have tabled them so they will be noted. Could you please, if there are further replies that you might have, reply to them with written replies? We would

find that most helpful. But I am going to ask each of you just to make some concluding points. I start with the slings of outrageous fortune, Mr Woolhouse, that Viscount Brookeborough threw in your direction. You might like to try to respond to some of the points, but in particular to the question about there seeming to have been little work done to see the FTT coming down the line and how it might affect British business. I think small businesses were part of that. You may want to reply to that. I am sorry; it really is very telescoped now, but I would be most grateful for your best efforts.

Richard Woolhouse: I will try to be brief. I think you will have assessed that we think this is a bad idea. It is bad for growth. We think there are genuine questions about the extraterritorial impact of this tax, and we think there are issues about how it might be administered. I would just like also to make the point that there seems to be again a sort of philosophical underpinning to all of this that large amounts of financial activity have no economic value. This was kind of picked up in the way that the impact assessment was done. A lot of derivatives activity is essentially assumed to have zero value. There are a lot of activities that take place in financial markets which are not just to do with plain vanilla issuance of shares and bonds, things like repo activity, hedging activity and stock-lending activity. There will be a big impact on a lot of those areas if this goes through.

On the impact on the City, I do not want to overplay it. There has been a lot of work done on the impact of this overall. It is just that, I suppose, people may have underestimated the political will to actually take this forward. A lot of people thought it was so economically damaging that it would be unlikely to be imposed unilaterally; I suppose that is why. There is work being done—it has been worked on—on the financial contribution of the City, about whether financial services are undertaxed, and the questions about the substitution effects are very complex and difficult to assess.

Viscount Brookeborough: Do you think the Government—

The Chairman: Mr Vella? Again, I am so sorry that it is foreshortened.

John Vella: I guess I should not summarise everything I have said before, but I shall just make a point about whether this increases the likelihood of the tax being adopted at a global level. One could think that the introduction of the tax by a small group of states actually gives an incentive to other states not to introduce the tax, because by not introducing it they will attract business from those which introduce it. So it might have the opposite effect.

Q18 The Chairman: One bears in mind Sweden in 1983, I think it was. Mr Bergmann, finally: your opportunity to say some final words. Again, I do apologise for so foreshortening this exchange.

Manfred Bergmann: Lord Chairman, thanks a lot, and I appreciate having been allowed to provide some evidence here and that you have invited the Commission.

Of course, the proof of the pudding is in its eating, so the 11 member states will have to show that it works. The Commission and all 11 member states think that they have mastered the critical mass of a market because, after all, the four big continental economies are in, and all 11 represent over 90% of the eurozone economy and about one-sixth of the global economy. There might be the risk of tax havens or whatever, but as soon as actors want to serve this big market with financial instruments they will have to pay the tax. So there is a remote risk of relocation here, but the market is that big that they will not be able to escape this.

Also, with respect to the City of London, Wall Street or Hong Kong, it might not be that the Governments (of these countries) support the collection of the tax, but it might be German banks, French banks or Italian banks who want to invite the trading platforms to co-operate and to collect the tax so that they do not have to bother any longer about this. If the 11 member states introduce a system which, with the help of the trading platforms and market infrastructure, is collected on the spot as a withholding tax, banks do not have to bother any longer—only once a year or once a month they will hand in a tax return. If other non-co-operative trading platforms were not helping them to pay the tax, they might have second thoughts (as regards trading) here.

SMEs: They should not be concerned about this, because most of the transactions are not taxed. We should not forget we have about 20 million SMEs in Europe, and perhaps about only 10,000 of these are financing part of their investment with the help of issuing shares or enterprise bonds.

Alternatives to the tax:—You should not forget that in the discussion under the Danish presidency in the first half of 2012, alternatives to the FTT or within the realm of FTT, such as stamp duty, have been discussed. None of these other alternatives received the required unanimous support by 27 member states, going so far that one or two member states even said, "Don't impose our tax on us" when their tax was discussed as an alternative. Some did not see the need for harmonisation at the European level. That is why the 11 member states have also said, "We would like to try it out now with 11. Perhaps we will get unanimous support by the 11 for the initial proposal, at least with respect to the objectives and the scope". That is where the UK comes in again. The UK will be on the table and will remain involved until the last moment—in principle, until the vote is cast. Only when the vote is cast, only the 11 participating—or by that time perhaps some more—will be allowed to vote and the others not. But all the discussions leading to this casting of the votes will be among the 27, or, as of the middle of this year, 28 including Croatia.

To close, these 11 will have to at first agree on something and then they have to show that it works. Even if we talked about own resources or whatever, at the end of the day 100% of the money will accrue to the participating member states. Whether it goes through the EU budget is only a question of secondary revenue-sharing. Primary revenue-sharing will be according to the seven criteria we have in our Article 4. If they then agreed to put revenues into the EU budget and in return get money back via the GNI key and not via the key by which they have contributed, that is their choice and I also understand that the other member states would not stand in the way of that approach.

The Chairman: Colleagues, in concluding this open session, I remind the witnesses that we will send transcripts: please correct them. Please also send your further thoughts on those last four questions if you would. Mr Vella, we would welcome that paper, and Mr Woolhouse, your two offered contributions, which we are very grateful for. Mr Vella, Mr Woolhouse: you are old hands at this Committee and we are ever grateful to you for contributing again. Mr Bergmann, we are most grateful to you and your colleague for coming today. We hope you carry away with you some thoughts of what we have been wrestling with here, and perhaps it will help you wrestle in the Commission with the development, as you make the financial transaction tax come into being. If it comes into being, we hope we have helped you improve it, sir. But we are most grateful for you for coming today. Thank you very much indeed. I conclude the session and I ask Mr Phillips and his colleagues to step up.