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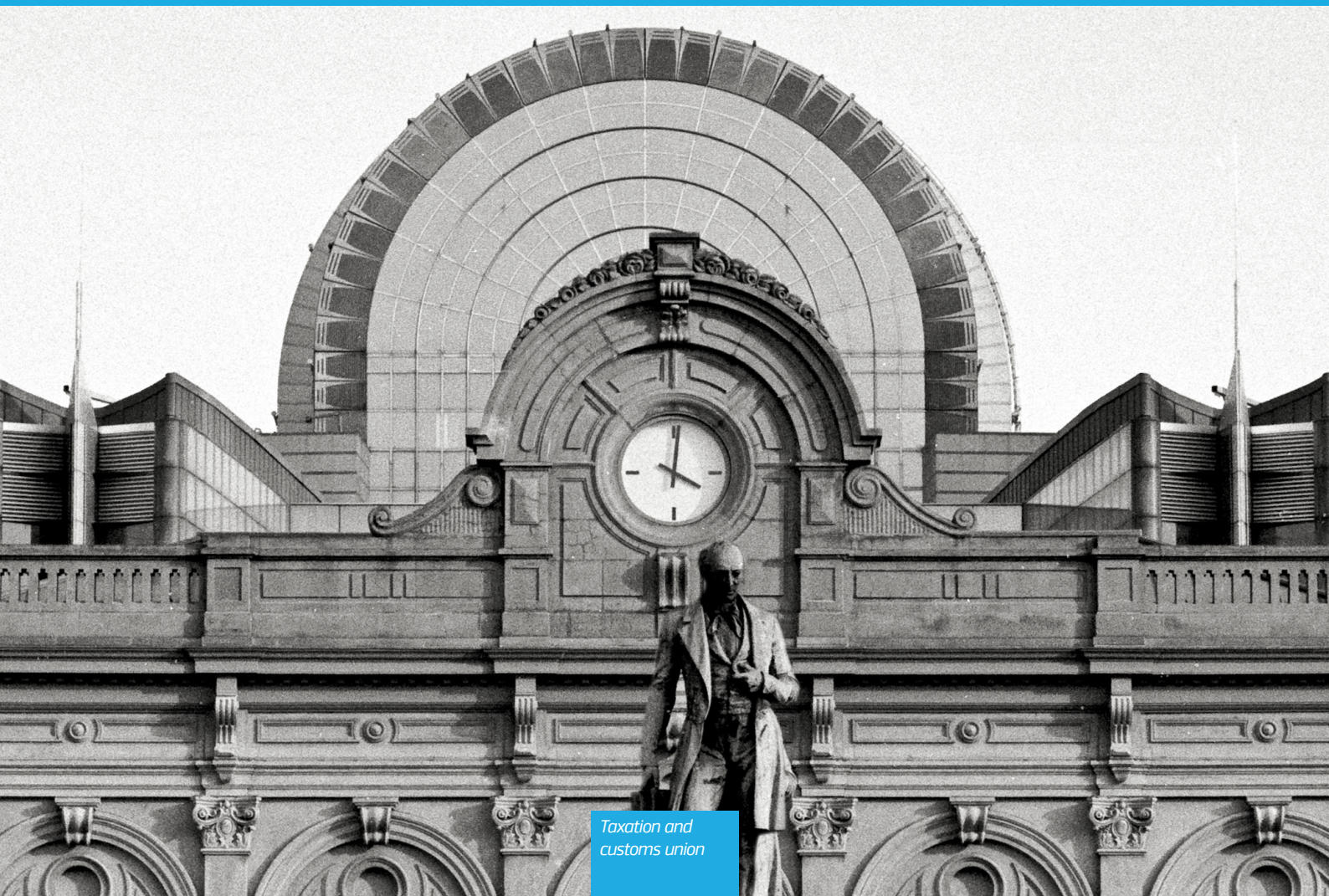
Review of Current Practices for Taxation of Financial Instruments, Profits and Remuneration of the Financial Sector



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Review of Current Practices for Taxation of Financial Instruments, Profits and Remuneration of the Financial Sector

The present document is the study on the review of current practices for taxation of financial instruments, profits and remuneration of the Financial Sector (below the ***"Study"***).

The economic and financial crisis has triggered political discussions on the taxation of the Financial Sector and whether there is a need to adapt tax systems to make the Financial Sector contribute in a fair and substantial way to public budgets. On 7 October 2010, The European Commission presented its communication on "Taxation of the Financial Sector (COM(2010)549 final)" and its accompanying Staff Working Document SEC(2010)1166, which assesses the Financial Transaction Tax and the Financial Activity Tax.

There have been debates in the Council, in the European Parliament, in the Economic and Social Committee, in the G-20, and in the Member States on the issue. These debates have shown diverging opinions between countries and between political and social groups, notably and foremost on the feasibility and efficiency of specific instruments, especially if implemented at the European level only.

One key issue in the debate is to what extent current tax provisions directed at financial instruments or the Financial Sector differ across countries and/ or differ from tax provisions in other sectors within countries. There is therefore a need for a comprehensive overview of current tax practices with regard to Financial Sector taxation in order to understand better the current taxation of the Financial Sector in the EU.

To this end, the Commission has instructed PwC to provide a review of the current tax provisions directed at the Financial Sector and financial instruments. The content of the Study is limited to the questions raised by the Commission in the questionnaires provided and is subject to certain limitations in terms of scoping as agreed by the Commission and detailed below in introduction of the respective Chapters.

The Study covers 4 different Chapters, namely:

- Corporate Taxation of the Financial Sector – Banks
- Value-Added Taxation of the Financial Sector
- Labour Taxation in the Financial Sector
- Taxation of Financial Instruments

The scope of this Study is to review current tax provisions directed at the Financial Sector in the 27 Member States as well as – for comparison purposes – certain key third countries: China, Singapore, Switzerland and the USA. The reference tax year is 2011.

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CHAPTER 1: Corporate Taxation of the Financial Sector

1. Purpose and Scope of this Chapter

1.1. Scope of the Study

1. Initially, it was contemplated that, for each of the below questions, and where applicable, the treatment for banks, insurance companies, credit card companies, stock brokerages, investment funds and government-sponsored companies should be detailed separately.

2. However, investment funds are generally subject to a special taxation regime, which differs according to their legal structure (that of a company or otherwise), the type of assets in which they invest (debt, equity, real estate, derivatives, commodities, and so on), and in relation to other features. Given the philosophy of the Study as mentioned above, we believe that, since the tax rules applying to investment funds are so specific (in view of their role as mere intermediaries), the result could be relatively confusing if investment funds were to be included in the scope of this Study. Indeed, given the diversity of the tax regimes applying to different types of investment funds, we have suggested a separate project to compare them and, therefore, investment funds have not been included within the scope of this Study.

3. In addition, because credit card companies, government-sponsored companies and stock brokerage companies are generally in a comparable situation to companies active in the non-Financial Sector, those entities have also been omitted from this Study.

4. Finally, in the interests of time and budget, insurance companies have also been omitted – with the Commission's consent. In a later stage, the Study could ideally be completed with a specific Chapter relating to insurance undertakings.

5. In conclusion, the questions raised in relation to corporate taxation relate only to 'banks', in the event that the tax rules applying to them differ from those applying to companies in the non-Financial Sector.

6. In their traditional acceptance, 'banks' are the most important category of credit institutions. Whereas their main activity still consists in receiving money deposits or other refundable funds from the public and in granting credits for their own account, the banking activity has in recent years been expanded and diversified and usually also includes the following activities: retail banking, business/corporate banking, investment banking or corporate finance, private banking and insurance banking. In the scope of this Study, we cover all types of banks whatever their activities provided that they are regulated (i.e. they have a banking licence in their country of establishment).

1.2. General Purpose of the Study

7. Given the scope of the Study as detailed above, we understand that the Commission mainly wishes to conclude what differences exist in the corporate taxation of companies active in the Financial Sector (i.e. regulated banks in the framework of this Study) as opposed to those in the non-Financial Sector on the basis of input by the survey countries (listed above) to a questionnaire formulated by the Commission looking at some elements of corporate taxation.

8. As the intention is mainly to identify differences in corporate tax treatment between the Financial and non-Financial Sectors, in principle, the questions in the questionnaire need no reply if the tax rules applying to the Financial and non-Financial Sectors are the same. Please note that, to maximise the practical value of the Study, we took the liberty of asking each country involved to briefly comment on each of the questions, even if there is no difference in treatment. These comments do however not address the overall tax regime applying in the survey countries. This will allow the Commission to have a high-level overview of the applicable differences across countries, which is also an objective of the Commission with respect to this Study.

9. Based on the survey input, when comparing corporate taxation between banks and other companies within one country or when comparing the rules applying in different countries, the general tax regime applicable within the given countries should be borne in mind. For instance, because Estonia defers corporate taxation until the distribution of profits, concepts of 'tax deductibility' or 'taxable items' do not necessarily have the same meaning as in other countries providing for an annual corporate income tax based on accounting results.

10. The purpose of our comments is to provide a general overview of the main tendencies common to all the countries or, where relevant, relevant exceptions to our general observations.

11. They are not intended to detail all the items addressed in the responses to the questionnaire. For a thorough, detailed overview of the regime, rules or practice in a given country, we refer to the completed questionnaires attached to this Study (see Enclosure 9).

1.3. Questionnaire

12. This Chapter answers the following questions raised by the Commission:

A. General tax rules applying to banks

1. What is the applicable corporate income tax ('CIT') rate, including any surcharges and local taxes (in which case the capital city is considered)?
2. Do banks pay a special tax rate or can they qualify for a special tax rate?
3. Do rules to compute the corporate tax base generally differ from those applied to other sectors? If so, in what respect?

4. Do countries impose turnover taxes on gross interest and other income of banks?

B. Specific tax rules applying to banks

1. Do countries have specific tax-relief rules for certain specific items such as interest income?
2. Are there specific anti-avoidance rules (CFC, thin cap, etc.) that apply to the Financial Sector (banks) or that differ from other sectors? Are there special rules to avoid offshoring of profits?
3. Are (some) types of financial companies excluded from double-tax agreements?
4. Do countries have specific rules for the taxation of subsidiaries and branches of banks?

C. Tax treatment of interest and dividends

1. How are paid interest and dividends treated for CIT purposes?
2. How are received interest and dividends treated for CIT purposes?
3. How are dividends on shares treated for tax purposes (from a WHT/WHT perspective)?
4. How is interest on advances and on securities of all kinds treated? Accrual basis, mark-to-market or included in the value of the security?
5. Under your domestic law, is there WHT due for interest paid to third parties? If so, is there WHT due by the head office (situated in your country) in case a foreign branch of the same bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party?

D. Tax treatment of certain specific gains/losses

1. How are gains and losses on fixed assets treated for tax purposes?

E. Tax treatment of certain financial practices/instruments

1. How are discounts on government bills, trade bills and other like instruments treated for tax purposes?
2. How are assets held for trading purposes treated for tax purposes?

F. Tax treatment of bad or doubtful debts on advances and loans

1. How are bad or doubtful debts on advances and loans treated for tax purposes?

   (i) Is a minimum required for general provisions?
   (ii) Tax-deductibility of general provisions?
   (iii) Limitation on deductibility of general provisions?
   (iv) Are specific provisions discretionary?
   (v) Tax-deductibility of specific provisions?
   (vi) Limitation on deductibility of specific provisions?

G. Tax treatment of employee stock option plans

1. Are employee stock option plans deductible for CIT purposes?

H. Specific questions regarding banks

1. Do accounting practices allow banks to use accounting discretion to under/over-state the book value of capital?
2. For all the above questions, are there differences in the provisions applicable to subsidiaries and branches of non-domestic banks?

G. Practices

1. For all the above questions, is there any information as to whether actual practices may differ from the legal provisions?

As detailed above, the scope of this Chapter covers and is limited to the corporate taxation of banks in the 27 Member States of the European Union plus China, Singapore, Switzerland and the United States of America, so 31 countries in total. The reference tax year is 2011.

2. Action Undertaken

13. To gather the necessary information, we sent questionnaires with the above questions to our contact persons in the 27 Member States and the four third countries. Based upon the answers received, a detailed analysis was performed, including the necessary PwC quality checks. Where needed, PwC reverted back to the different countries for additional explanations.

Taking into account the input provided by the survey countries, we subsequently did a transversal reading of each question and the replies provided by each of the countries.

As a result, we identified certain common tendencies between certain countries or, by contrast, certain specific rules peculiar to one or a limited number of countries.

For the sake of completeness, we attach the different questionnaires as completed by the survey countries (see Enclosure 9).

3. Results

3.1. General Tax Regime Applying to Banks

3.1.1. Applicable CIT Rate, Surcharges and Local Taxes

14. **Applicable CIT Rate.** As regards the applicable corporate income tax rate, most of the survey countries, if not all, do not provide a different standard corporate income tax rate for banks. The corporate income tax rate applying to banks is generally the same as that applying to other companies.

Notwithstanding the above, although not material, Austria provides for a minimum corporate income tax, which is due on an annual basis. In this respect the annual minimum corporate income tax due for

banks amounts to EUR 5,452, whereas, in general, for non-financial institutions this annual corporate income tax is only EUR 1,750 (EUR 3,500 for public limited liability companies).

15. **Statutory Tax Rate.** For the purposes of the Study, the input provided by the survey countries – especially in relation to this first question – relates to the question whether banks benefit from a different nominal tax rate than the ordinary corporate tax rate applicable to other corporates. This Study analyses the 'statutory tax rate' or the 'standard tax rate', i.e. the rate that is applied on the taxable basis as determined by the applicable rules. The statutory tax rate or standard tax rate should not be confused with the "effective tax rate" (ETR) which is an accounting concept and which is not relevant with regard to this Study.

16. **Surcharges and Local Taxes.** Based on the input provided, we understand that local taxes may be applicable in a limited number of countries. We have received confirmation that local taxes are indeed applicable in Italy, Luxembourg, Portugal, Romania and the USA. The general conclusion is that the applicable local tax rate is the same for banks as for other companies. By way of exception, it appears that the reduced local tax rate available within the Madeira Region (Portugal) is not applicable to banks. For the purposes of this Study, we consider local taxes as meaning additional taxes, i.e. on top of corporate income tax, levied by or in favour of local authorities, on income generated by banks. Essentially, these local taxes are thus levied on the same type of income as corporate income tax. Except as otherwise indicated, we do not include in the Study any references to other specific taxes levied by local authorities such as real estate tax, computer tax, office's tax, ATM's tax etc.

3.1.2. Special Tax Rate for Banks

17. **No Special Corporate Income Tax Rate.** None of the survey countries reported a special corporate income tax rate for banks.

3.1.3. Computation of the Tax Base

18. **Computation of the Tax Base.** For computing the corporate tax base, all countries state that, in principle, it is based on the accounting result as determined by the financial statements drawn up in accordance with the applicable accounting standard (IFRS, local GAAP, etc.).

In this respect, it should be noted that, taking into account the specific nature of financial activities and financial products, there may be specificities in the accounting rules applying to financial institutions or banks, which may influence the accounting result and thus the corporate tax base. In addition to the accounting specificities that may apply to the banking sector, tax laws of certain countries also provide for certain tax adjustments that might not always be specific to banks but that, due to the nature of banking activities, could nonetheless have a more relevant impact on their tax base as opposed to that of

other companies. For the sake of clarity, the present Study does not cover the accounting treatment applicable to banks, nor the impact of said accounting treatment on the computation of the tax base.

19. **Tax Adjustments.** The tax adjustments mentioned above relate, for instance, to provisions for bad or doubtful debtors, taxation of unrealised or realised gains and losses on certain financial instruments, application of the participation exemption regime for dividends and/or the capital gains exemption in the case of trading assets and certain thin capitalisation rules. These tax adjustments are further detailed below.

20. **Tax Losses.** In relation to determination of the tax base, we have also been told by Hungary that, specifically for banks, tax losses incurred in and before 2008 cannot be carried forward.

3.1.4. Turnover taxes

21. **Turnover Taxes.** Apart from France and China, no other countries reported any turnover taxes on gross interest or other income.

In France, a 'value added contribution' ('Cotisation sur la valeur ajoutée des entreprises') is assessed on the added value of French companies. This applies to banks and other companies where their turnover exceeds EUR 152,500. The tax is computed by applying a progressive rate ranging between 0% and 1.5% on the added value of the company. Both turnover and the added value are calculated according to special provisions for banks (e.g. 95% of dividends deriving from long-term investments are not taken into account instead of a complete exemption).

In China, a 5% business tax applies to gross interest and other income of banks.

22. **VAT.** For those countries explicitly referring to value-added tax, it was mentioned that banking services and activities are generally exempt from VAT and, as a consequence, banks may generally not deduct the VAT suffered on their incoming invoices. We refer to Chapter 2 of the present Study for more details with respect to some VAT aspects applicable in the Financial Sector.

3.1.5. Conclusion

23. **Conclusion.** Based on the above, at first sight and based on the common parameters as detailed above (tax rate, tax base, turnover taxes, etc.), it can be concluded that there is generally a limited difference in tax treatment between banks and other companies, with the exception of bank levies described below.

We refer to Enclosure 1 for an overview table of the corporate income tax rates, local taxes and special levies per survey country as summarised by the various jurisdictions.

3.2. Specific Tax Regime Applicable to Banks

3.2.1. Tax Relief Rules

24. **No Specific Tax Relief Rules.** Apart from Singapore, no country identified any specific tax relief applicable to certain specific types of income received by banks as opposed to other companies. In all the survey countries (except Singapore), interest income is subject to the standard CIT rate and there is no particular income tax deduction/relief for interest income in the case of banks.

In Singapore, banks can apply a reduced concessionary tax rate for income from high-growth and high-value-added activities such as relating to the bond market, derivatives market, etc. (so-called standard-tier) or for income from a broader range of financial activities that are important to the development objectives of the Financial Sector in Singapore (so-called enhanced tier) such as lending in foreign currencies, treasury activities, etc. The reduced concessionary rates for both types of income amounts to 5% and 12% (instead of 17%), respectively. These tax incentives are included in the so-called 'Financial Sector Incentive' Scheme, which is designed to promote and encourage further development of Singapore as a prominent financial services hub.

3.2.2. Specific Anti-Avoidance Rules

25. **General Comments.** In order to reduce the tax that due, a company may utilise the applicable tax regime to its own advantage. For instance, in relation to their funding requirements, companies can choose to be funded via equity or debt. Generally, debt financing brings additional tax benefits compared to equity financing considering the fact that interest expenses are generally tax-deductible (whereas dividends are distributed after tax and thus are not deductible). By means of high debt financing, the tax base may be eroded through interest expenses. With the aim of discouraging excessive or abusive use of financing methods that impact the tax base, the majority of countries have introduced anti-avoidance rules, which may be general or specific (i.e. aimed at specific expenses, transactions, etc.).

26. **Thin Capitalization Rules.** In order to limit risk in the case of excessive debt financing (solvency risk for creditors) and so minimise the adverse tax consequences of excessive interest deductions, certain countries have set up 'thin capitalisation rules' or rules 'limiting interest deductions'.

In general terms, thin capitalisation rules determine how much of the interest paid on corporate debt is deductible for tax purposes, thus limiting the amount of interest deduction when a certain debt-equity ratio is exceeded. In certain countries, rules also provide for a limitation of interest expenses, for instance when they exceed interest income (this is the case in the Netherlands, for instance).

Thin capitalization rules are applicable in the majority of the countries in scope of the Study, with the exception of ten countries (Belgium, Cyprus, Estonia, Finland, Ireland, Italy, Malta, Slovakia, Sweden and Singapore).

27. **Various Categories of Thin Capitalization Rules.** The countries in which the thin capitalization rules apply may be divided into three categories:

1. The countries in which the thin capitalization rules apply in the same way to the banking sector as to the other sectors (Austria, Germany, Lithuania, Luxembourg, the Netherlands, Poland, Portugal and the USA);
2. The countries in which the thin capitalization rules apply to banks, but in a different way (Czech Republic, Hungary, Switzerland, the UK and China); and
3. The countries in which banks are excluded from the thin capitalization rules (Bulgaria, Denmark, France, Greece, Latvia, Romania, Slovenia, Spain).

In Germany, although the thin capitalization rules are similar for banks and companies in other sectors, in practice, the banks will however not be burdened by the German thin capitalization rules (due to the fact that interest expenses are always deductible to the extent they do not exceed interest income earned).

Where the thin capitalization rules differ for the banking sector, the difference may be in the applicable debt to equity ratio. For instance, in the Czech Republic and China, the debt to equity ratio applicable to banks is higher. The difference may also be present in the borrowings which have to be taken into account to compute the debt to equity ratio. In Hungary for instance, banks do not have to take into consideration their liabilities in connection with their financial services activities, and in the UK group's external borrowing are not taken into account to determine the debt cap restriction. These differences are due to the nature of the activities of a bank. Indeed, in order to enable a bank to perform its lending activity, the bank itself needs to fund this activity through borrowings.

We refer to Enclosure 2 for an overview table of the applicable thin capitalization rules, as well as the differences applicable to banks, where relevant.

28. **Incentive Rules for Equity Funding.** For the sake of completeness, it is worthwhile to mention that in contrast to the above 'negative' rules to prevent an entity being 'thin capitalised', certain countries may also provide for positive incentive rules from a tax perspective to encourage companies to be equity funded. For instance, Belgium has introduced a notional interest deduction regime, which mainly consists in a tax deduction corresponding to a notional interest cost computed on adjusted equity capital. This regime was introduced to (re)equilibrate the tax treatment of equity funded companies and debt funded companies.

29. **Other Anti-Avoidance Rules.** It should be noted that not all countries have anti-avoidance rules. Where domestic legislation does set down anti-avoidance rules, they generally apply to all companies, and thus not specifically or solely to banks. In this respect, only the USA has reported certain specific anti-avoidance rules applying to the Financial Sector, and thus to banks (many relate to profit offshoring). It should also be noted that the case law of the Court of Justice of the European Union has set stringent rules to the application of these rules in the light of the European freedoms.

30. **Conclusion.** Very few countries have enacted specific tax rules to limit interest deductions by banks.

This can probably be explained by the fact that accepting deposits from customers (and granting loans), coupled with the payment of interest on those deposits, is the core activity of the banking sector. Hence, there is little tax incentive linked to the deduction of interest payments; they are more a business characteristic inherent to the Financial Sector, especially banks.

In addition, at least one country also explicitly referred to applicable capital requirements from a regulatory perspective, under which banks' funding should be sufficiently regulated in principle and hence no further corrective measures (from a tax perspective) need be undertaken in this respect. Generally, such regulatory provisions (such as Basel I, Basel II, the EU Capital Requirements Directive reflecting Basel II, etc.) are intended to create an international standard that banking regulators can use to determine the capital/resources banks need to have to protect them against the financial and operational risks they face.

3.2.3. Double Taxation Treaties

31. **Treaty Access for Banks.** Where there are double taxation treaties between the survey countries, none of them has reported that, provided they can be considered to be corporate bodies, banks are excluded from the benefits they procure.

In other words, banks, just like any other standard company, can in theory benefit from the advantages of double taxation treaties if they qualify as a 'resident', as defined by the treaties: this will be so in most cases (subject of course to a case-by-case analysis under the laws of the relevant country, the specific situation of the taxpayers involved and the double taxation treaty in question).

3.2.4. Branch v. Subsidiary

32. **No Specific Taxation Rules.** There are no specific taxation rules that treat banks organised as branches differently from those organised as subsidiaries.

33. **Interest Deductibility.** Certain countries nonetheless specify that branches of banks – as opposed to other branches –, may deduct interest paid on loans received from their head office due to the specific nature of their finance activities (for instance Belgium, Portugal, Spain and the UK).

Generally, in the case of a head office and branch structure, the head office will allocate a capital to its branch to enable it to secure its activities. In principle, because a branch cannot be considered a separate legal entity, any interest due on this working capital is, if it is structured as a 'loan', not deductible in the branch's hands (because it is paid to itself, legally speaking). However, this is not generally the case for financial institutions such as banks. In this respect, the OECD Model Convention states that there is good reason for this exception because making and receiving loans is closely related to the ordinary business of such an undertaking.

3.2.5. Bank Levy

34. **Methodology.** Although not specifically addressed in the questionnaire for this Study, we asked our contacts in the 27 Member States and the four third countries whether a bank levy applies in their country. If so, we asked them to briefly explain how it is calculated (tax rate, taxable base, etc.).

The detailed answers to this additional question are to be found in the different country responses to the questionnaire enclosed. In addition, we include relevant brief comments in the table summarising our answers to the first set of questions in Enclosure 1.

35. **Principles.** A bank levy or bank tax is to be interpreted as an additional tax imposed on financial institutions, predominantly banks. Following the recent financial crisis, several countries (of which certain countries in scope of the current study) have taken legislative initiative in this respect, such as an additional levy applicable to banks, which are considered to pose a systemic risk to the economy. Although there are current proposals and negotiations pending in this respect, up to now there is no common approach, for instance between the EU Member States, in relation to such tax. Generally such bank levies are not applied on the income/accounting result of the bank (as the case for corporate income tax), but are in principle levied on the (relevant) assets, liabilities or capital of the bank.

For such type of tax, generally no deductions, reductions, exemptions, etc. apply. Such tax thus contributes to an increase of the overall tax burden of banks as opposed to other companies. Moreover, considering such tax is in principle not in scope of double tax treaties concluded by countries, and taking into account the inconsistent approach between various countries as regards to the tax base and entities in scope (branches of foreign banks, etc.), a possible double taxation in the hands of banks with a multinational character appears a likely outcome.

36. **Difference in Treatment.** Based on the above, it can thus be concluded that, with respect to bank levies, there is a difference in tax treatment between banks and other companies, whereas with

regard to the general tax rate, as mentioned earlier, the tax base and turnover taxes such difference is generally only limited.

3.3. Tax Treatment of Interest and Dividends

37. Traditionally, the core function of a bank is lending. Banks accept money from clients (deposits) and lend money to clients (lending). In such a scheme, a bank's income generally corresponds to the spread, being the margin between the interest paid (e.g. on the deposits it receives from clients, on commercial papers issued, on loans, on bonds, etc.) and the interest rate it charges on money lent to clients. Over time, banks have also acted as important investors, also deriving income from various types of financial instruments.

Hence, one of the main components of the income statement of a traditional bank are generally (i) interest paid, (ii) interest received, (iii) dividends received and (iv) gains and losses realised on investments.

3.3.1. Tax Treatment of Interest

3.3.1.1. Corporate Income Tax Treatment of Interest Paid by Banks

38. **Deductibility.** Generally, interest paid by all companies, including banks, is tax-deductible.

However, in certain countries, deductibility may be subject to certain limitations set by thin capitalization rules or anti-avoidance rules, where these rules apply to banks (see our comments above, 3.2 'Specific tax regime applicable to banks').

3.3.1.2. WHT Treatment of Interest Paid by Banks to Third Parties

39. **Absence of WHT.** Certain countries do not provide for a general WHT on interest payments. Such is the case in Cyprus, France, Hungary, Luxembourg, the Netherlands and Sweden. Also in Estonia, a WHT is only due in the case of excessive interest payments.

40. **WHT on Interest Payments.** In principle, for all other countries, interest payments are subject to a WHT of which the rate varies from 5% (in Latvia) to 35% (in Switzerland). We refer to Enclosure 3 for an overview table of the summarising the statutory WHT rates applicable to interest payments in the survey countries. This overview table does not reflect reduced rates and/or exemptions under double tax treaties/domestic legislation.

41. **Exemptions/Reductions.** As mentioned above, overall WHT exemptions or reductions may be provided by domestic law, double taxation treaties, etc. It is not the purpose of this Study to enter into the details and mechanics of all these WHT exemptions since, given the diversity and complexity of all

these rules, it would required a study as such on this topic. That being said, these exemptions mainly depend on various parameters:

- The capacity of the debtor, i.e. bank (Such is the case e.g. in Denmark, Germany, Slovenia (except in the case of payments to tax havens) and the UK (except for payments to UK individuals));
- The capacity of the beneficiary, i.e. a non-resident beneficiary (such is generally the case e.g. in Finland, Lithuania and Malta) or a bank (such is the case in Belgium or in France for instance);
- The location where the bank account of the beneficiary is open (such is the case in France for instance);
- The nature of the underlying asset;
- Etc.

42. **Specificities.** In the following countries, we have noticed the following specificities.

- In Germany, a specific exemption from the obligation to withhold tax on interest payments (so called "bank privilege") is applicable in cases of German domestic interbank loans;
- In Slovakia, no WHT applies on interest received by a Slovak or Slovak non-resident bank from deposits on bank accounts;
- In Slovenia, interest paid by Slovene banks is not subject to WHT unless paid to tax haven countries;
- In the UK, there is a general exemption for a bank making interest payments in the ordinary course of its business to a company (on payments to individuals withholding may be required). UK withholding tax does not apply to interest on an advance from a bank if that bank is within the charge to Corporation tax as respects the interest. However, there is also a general exemption from the requirement to withhold on interest payments between UK tax resident companies;
- In Singapore, the government has granted a remission of withholding tax on all interest and related payments made by approved banks in Singapore to their overseas branches, head offices or another branch outside Singapore. Based on the recent Singapore budget, it was announced that with effect from 1 April 2011, the banks and certain financial institutions will be exempted from withholding tax on interest and related payments made to all non-residents (other than permanent establishments in Singapore) so long as these payments are made for trade or business purposes. This exemption is for such payments made during the period 1 April 2011 to 31 March 2021;
- In Switzerland, interest paid by a Swiss bank is in general subject to Swiss WHT, however, there is an exemption for interest paid by a Swiss bank to another (Swiss or foreign) bank.

3.3.1.3. Corporate Income Tax Treatment of Interest Received by Banks (as Beneficiary) on Advances and Debt Securities of All Kinds

43. **Taxation.** Interest received – whether on advances or debt securities of all kinds – is generally included in the taxable profits of all companies, including banks. As already mentioned, none of the

countries surveyed reported that interest income could benefit from a more-favourable tax treatment in deviation from this principle.

44. **Timing of Taxation.** It should be noted that the timing of taxation of interest income on debt securities may depend on different factors. For instance, whether the security is used for hedging, lending, trading or other purposes. The timing of the taxation of interest depends on the specific kind of the security and should be determined on a case-by-case basis. As a result, in answering the question regarding the taxation of interest, most countries only dealt with interest payments made on 'regular' advances (loans).

45. **Accrual Basis.** Generally all the countries report that interest income is recognised on an accrual basis from a tax perspective (in conformity with the applicable accounting rules). Interest is thus recognised in the accounting period to which it relates/in which it is earned, irrespective of when it is actually received. Having said this, there are circumstances in which interest income is not accounted under the accrual basis, which in turn has an impact on taxation (because in most countries tax treatment is based on the accounting treatment). For instance, in Malta, interest may possibly be taxable on a cash basis in specific circumstances (i.e. when interest income is not recognised as trading income). In some countries, interest will generally be taxed on a cash basis (Poland).

46. **Banks v. Other Companies.** In relation to this question, no significant differences were reported between the applicable tax treatments in the hands of banks as opposed to other companies.

3.3.1.4. WHT on Interest Payments Made to Banks

47. **Payments to Resident Banks.** Almost all the survey countries report that no WHT applies on interest payments made to a resident bank.

48. **Specificities.** In the following countries, we have noticed the following specificities.

- In Germany, as already explained, a specific exemption from the obligation to withhold tax on interest payments (so called "bank privilege") is applicable in cases of German domestic interbank loans;
- In Greece, interest paid by Greek residents to ordinary Greek companies is subject to a 20% WHT (as securities income). There is a WHT exemption for interest paid to Greek banks which is based on the characterization of the interest as ordinary business income for the banks;
- In Poland, no specific regime for banks in the domestic tax regulations exists. However, specific regulations, in particular WHT exemptions, on interest paid to banks exist in some of the double tax treaties concluded by Poland;
- In Portugal, interest paid to a company is generally subject to WHT, while interest paid to a resident bank is exempt from WHT. However, WHT is a mere payment on account for residents, so the final tax burden will be the same;

- In Singapore, interest payments made to a Singapore branch of a foreign bank will not be subject to withholding tax if the recipient has obtained a relevant waiver from the Singapore tax authorities;
- In Switzerland, as already explained, interest paid by a Swiss bank is in general subject to Swiss WHT, however, there is an exemption for interest paid by a Swiss bank to another (Swiss or foreign) bank.

49. **Payments Made to Non-Resident Banks.** In case of interest paid to a non-resident bank, many countries report that no WHT is due. However, this is often subject to additional conditions. In Belgium, the bank must be established in a country of the European Economic Area or with which it has concluded a double tax treaty. In France, the bank must not be located in a Non Cooperative State or Territory. In Germany, a WHT of 26.375% is only applicable if the interest is paid by a German bank to a foreign bank and the interest or the underlying loan facility is collateralized with German real estate or German ships.

50. **Double Tax Treaties and Interest – Royalties Directive.** Furthermore, in the countries where a WHT on interest applies, many countries reported that an exemption or reduced rates resulting from double tax treaties or from the implementation of the Interest – Royalties Directive may apply.

3.3.1.5. WHT Treatment in a Triangular Situation

51. **Triangular Situations.** Under this Section, we comment whether there is a WHT due by the head office of a bank (situated in a given survey country) in case a foreign branch of that bank (i.e. its permanent establishment situated abroad) pays interest (on a debt which is borne by the permanent establishment) to a third party.

52. **Absence of WHT.** In case a foreign branch pays interest to a third party (on a debt which is borne by said foreign branch and is thus not allocated to the head office), all countries have reported that no WHT should be levied by the head-office. Indeed, in order to determine whether domestic WHT is due, all the survey countries refer to the source-state principle.

3.3.2. Tax Treatment of Dividends

3.3.2.1. Corporate Income Tax Treatment of Dividends Paid by Banks

53. **Dividends Paid.** Contrary to the interest payment, dividend payments/distributions are not deductible in the hands of the distributing company because this concerns an allocation of taxable profits.

3.3.2.2. WHT Treatment of Dividends Paid by Banks

54. **Scope.** The applicable WHT on dividend payments that have been examined are the applicable (if any) WHT on dividend payments made by a bank (this does not cover the domestic WHT applying to banks as recipients of dividend income).

55. **Absence of WHT on Dividend Payments.** Certain countries do not provide for a WHT on dividend payments. Such is the case in Malta, Singapore and the UK.

56. **WHT on Dividend Payments**. In principle, in most other countries, dividend payments are subject to a dividend WHT. We refer to Enclosure 4 for an overview table summarising the statutory dividend WHT rates applicable in the survey countries. This overview table does not reflect reduced rates and/or exemptions under double tax treaties/domestic legislation.

57. **Exemption Provided by the Parent-Subsidiary Directive.** Overall, all the European countries also cite the possibility of an exemption from dividend WHT based on the European Parent-Subsidiary Directive as generally incorporated into domestic legislation.

58. **Other WHT Exemptions/Reductions.** In addition, most countries also mention that an exemption or a reduced WHT rate can also be claimed for dividends paid based on double taxation treaties or local legislation and taking into account the specific facts and circumstances of the case.

59. **No Differentiated Treatment.** Generally, there is no major difference in the survey countries in the WHT treatment of dividends distributed by local banks and those distributed by local standard companies.

3.3.2.3. Corporate Income Tax Treatment of Dividends Received by Banks

60. **General Rule.** For dividend income, as for interest income, the general rule seems to be that the dividend income is taxable in the hands of the recipient.

61. **Relief Provided by the Parent-Subsidiary Directive.** However, most, if not all, European countries also allow the possibility of relief for dividend income (either via an exemption or a tax credit system) based on the European Parent-Subsidiary Directive as implemented into domestic legislation. Although this relief is also generally applicable to banks, due to the fact that it is often subject to a minimum holding period and a minimum holding requirement, it does not generally apply to dividends from trading assets or portfolio shares.

In line with this, certain countries specifically state that dividends received on trading assets are taxable (such is the case for Denmark, Germany, the UK and Singapore for instance).

62. **Third Countries.** For most of the non-EU countries surveyed, i.e. China (in the case of foreign dividends), Switzerland and the USA, it appears that dividend income is taxable and generally subject to the domestic corporate income tax rate. Taxation of dividend income may also be reduced in those countries through a foreign tax credit regime, participation relief or other exceptions or deductions.

In Singapore, an exemption is available for foreign dividends received by Singaporean-resident companies. This exemption is not available for Singaporean branches of foreign banks.

63. **No Differentiated Treatment.** Overall, with respect to dividends received, we have not identified any important differences between banks and companies active in other sectors.

3.3.2.4. WHT Treatment of Dividends Received by Banks

64. **Same treatment.** In general, dividends paid to banks and dividends paid to companies in other sectors are treated the same way for WHT purposes. We refer in this respect to the section above on "WHT Treatment of Dividends Paid by Banks".

3.3.3. Conclusion

65. **No Significant Differences.** Overall, regarding the corporate income tax treatment of interest paid/received and dividends paid/received, there are no apparent significant differences in treatment between banks and other companies.

66. **WHT.** On the other hand, countries with a WHT on dividends and/or interest generally also provide a range of exemptions dependent on: (i) the capacity of the debtor of the income, (ii) the capacity of the recipient of the income, (iii) whether the payment is made to a resident or a non-resident, etc. In this respect, we do not observe any uniform approach or universal principle among the survey countries. Nevertheless, in some of the survey countries, banks can benefit from a broader range of WHT exemptions, especially for interest payments.

We refer to Enclosure 5 for an overview table of the WHT treatment of interest and dividends paid to banks is described, as well as the differences applicable to banks, where relevant.

3.4. Tax Treatment of Gains and Losses on Fixed Assets

67. **Scope.** As agreed with the Commission, we narrowed the scope of this question to financial fixed assets (with the exclusion of other fixed assets such as real estate, equipments, etc.). "Financial fixed assets" refer to financial assets which are not held for trading purposes, and this includes financial instruments.

For the purposes of this Study, we made a distinction between two types of financial fixed assets: shares on the one hand, other financial instruments on the other hand. In addition, a distinction has been

made between the applicable tax treatment upon realised gains and losses, and upon unrealized gains and losses.

68. **Realized gains/losses on shares.** In respect to the taxation of shares which qualify as financial fixed assets, there is no consistent approach between the countries in scope. In the majority of countries, realized losses are tax deductible if the realized gains are taxable (this is the case for Austria, Bulgaria, Estonia (upon distribution only), Hungary, Latvia, Poland, Portugal, Romania, Slovenia, Spain and Singapore), and where realized losses are not tax deductible, the realised gains will in principle be exempt (this is the case for Belgium, Cyprus, Germany, Slovakia and China).

In certain countries, realized losses on shares may only be offset against gains which have a similar nature (this is for instance the case for Greece, Ireland, Lithuania and the UK). Ireland for instance, applies a so-called 'basket provision' (i.e. losses are deductible against capital gains realised during the same accounting period)

In other countries, the deductibility of the realized losses on shares will depend on the tax treatment which applies on the realized gains of said shares. For instance, only when realized capital gains on shares benefit from an exemption, the realised losses are not deductible for tax purposes (this is the case for the Czech Republic, Denmark, Finland, France, Italy, Luxembourg, Malta, the Netherlands, Sweden and Switzerland). Luxembourg, Sweden and Switzerland for instance cite an exemption provided the conditions of the participation exemption regime/participation relief are complied with (generally, a minimum holding period and minimum holding requirement). In Belgium, capital losses on shares are in principle not deductible even if the participation exemption conditions are *not* met.

In Malta, capital losses can be carried forward indefinitely to future years and absorbed against future capital gains. For the sake of completeness, in China, losses are only deductible if supported by a special purpose report. In Singapore, there is no tax on capital gains (and capital losses are not deductible).

69. **No Separate Capital Gain Tax.** In general, the countries do not report a separate capital gains tax. However, in Ireland, capital gains are taxed at a rate of 25% (compared to the 12.5% applying to trading income).

70. **Realized Gains/Losses on Other Financial Fixed Assets.** In respect to the taxation of other financial fixed assets (not shares), the countries in scope have a more consistent approach whereby realized losses are usually deductible for tax purposes, and realized gains are taxable.

71. **Unrealised Gains and Losses.** With respect to the tax treatment of unrealized gains and losses, we refer to the table contained in Enclosure 6. Compared to the non-Financial Sector, few countries identified differences in the tax treatment of financial fixed assets. The differences mainly relate to unrealized gains and losses being recognized for tax purposes in the banking sector (this is the case for Bulgaria and Sweden).

72. **Overview Table.** We refer to Enclosure 6 for an overview table of the tax treatment of gains and losses on financial fixed assets, as well as for the differences applicable to banks, where relevant.

3.5. Tax Treatment of Some Financial Practices/Instruments

3.5.1. Discounts on Government Bills, Trade Bills and Similar Instruments

73. **Scope.** For the purpose of answering this question, 'discounts' are understood as being the negative difference between face value and acquisition price of government bills, trade bills and similar instruments.

74. **No Differences.** Given the purpose of the questionnaire, none of the countries reported a difference in the treatment of such income in the hands of banks as opposed to other companies.

75. **Accrual Basis.** Generally, such income is recognised on a *pro rata temporis* basis until maturity, i.e. an accrual basis. From a tax perspective, the income is thus generally taxed on an accrual basis.

76. **Exceptions.** A limited number of countries provide that such discounts are taxable in the hands of the holder upon maturity, redemption or sale of the bill (this is the case for Germany and Poland for instance).

3.5.2. (Financial) Assets for Trading Purposes

77. **Scope.** For the purposes of this Study, we made a distinction between two types of financial trading assets: shares on the one hand, other financial instruments on the other hand. In addition, a distinction has been made between the applicable tax treatment upon realised gains and losses, and upon unrealized gains and losses.

78. **Taxation of Gains / Deduction of Losses.** In most countries, capital gains on trading assets are taxable whereas capital losses are tax deductible. In some countries, like for instance Belgium, Cyprus, France, Germany, Luxembourg and the Netherlands capital gains on shares may be tax exempt under certain conditions (a 95% exemption with respect to Germany and France).

79. **Unrealised Gains and Losses.** The tax treatment of unrealised gains and losses strongly varies from country to country and depends from the applicable accounting treatment (which we do not address in this Study).

Said accounting treatment has essentially an impact on the timing of recognition of these unrealised gains and losses and can lead to differences between banks and other companies.

For instance, in Bulgaria, unlike other companies banks recognize for tax purposes both realized and unrealized capital gains / losses (revaluation income / expenses are recognized in the period when incurred).

In Germany, financial instruments held-for-trading by a bank or a financial institution are measured at fair value since 2010. Therefore, unrealized gains and losses increase or decrease the taxable income and realized gains and losses on shares as financial trading assets increase or decrease the taxable income (i.e. the 95% tax exemption is not applicable in case of shares held by a bank or a financial institution as trading assets). Correspondingly, losses resulting from a disposal of such shares are recognized for taxation purposes. The same kind of tax treatment applies in Malta.

80. **Overview Table.** We refer to Enclosure 7 for an overview table summarizing the tax treatment of financial trading assets, as well as the differences applicable to banks, where relevant.

3.6. Tax Treatment of Bad or Doubtful Debts on Advances and Loans

81. **Definitions.** In our analysis of the input provided by the survey countries, we noted that general and specific provisions are not always interpreted uniformly due to differences in tax culture and jargon.

To compare the different rules and for the purposes of this Study, we therefore defined a general provision to be one determined on a global basis, based on a statistical approach, etc., without relating to specific identifiable bad risks/debts on advances and loans.

A specific provision is deemed to be (i) a specified provision – as opposed to a general provision, or (ii) a provision specifically available for banks.

3.6.1. General Provision

82. **Non-Deductibility.** Bearing in mind the meaning of general provisions as described above, the majority of the survey countries indicate that they are not tax-deductible.

83. **Particular Provisions for Banks.** Apart from this common approach, a limited number of countries consider a general provision, determined as a certain percentage of total outstanding debts/loan portfolio, as deductible, i.e.:

- In Czech Republic, there are special tax rules for creation of bank provisions against non-statute-barred receivables from credits. Banks may in the given year create tax deductible provisions up to 2% of all loan receivables towards these receivables (incl. accrued standard interest). The 2% is annual average balance calculated at the end of each month and 1 January. Only loans granted to EU companies are included into the base of 2% calculation and only to these loans tax provision may be created;

- In Finland, depository banks and other credit institutions are entitled to make a tax deductible doubtful debt provision annually. This provision cannot exceed 0.6% of the amount of total receivables outstanding at the end of the tax year. Other restrictions apply as well. Further, the amount of the annual provision together with provisions made in previous years cannot exceed 5% of the amount of outstanding receivables at the end of the tax year. If the provision exceeds the maximum in any one year, the excess is regarded as chargeable income for that year. In addition, depository banks and credit institutions may include e.g. loan/client specific provisions in certain cases in the general provision (within the limits of the general doubtful debt provision);
- In France, the French Tax Code entitle banks and credit establishments to deduct a specific provision for default risks over middle and long terms loans granted. In addition, a specific practice recognised by the French Tax Authorities allows bank establishments to maintain the tax deductibility of certain accounting provisions related to assets (classically loans, bonds, notes) held in risky jurisdictions ("*provision pour risque pays*"). The deductibility of the provision is limited to a certain percentage of the assets' value held in a risky jurisdiction ranging from 0.5% to 5%;
- In Germany, general provisions may be recorded based on experienced data of the past. As a general rule, a minor provision of 1% or 2% should always be acknowledged for tax purposes;
- In Greece, banks are entitled to deduct a general provision for tax purposes at a rate of 1% (or 2% for investment banks) of their annual average advances;
- In Italy, for banks, the amount of bad debt provisions accounted on the balance sheet that are not covered by insurance and that arise from lending to customers are deductible in each period up to 0.3% of the value of the credits accounted on the balance sheet plus write-offs recorded during the financial year. For other companies, bad debt provisions are deductible in each period within the limit of 0.5% of the total nominal value of credits. Total provisions can't exceed 5% of total nominal value of credits;
- In Lithuania, banks are not subject to specific requirements applied to other companies from non-Financial Sector. Specific provisions for bad debts recorded by banks may be deducted to the extent allowed by the rules of the Bank of Lithuania. There is no requirement that debt should be included into income in previous periods for banks. Also there is no requirement to obtain specific evidence for banks;
- In Luxembourg, risk and charges, lump-sum and AGDL provisions are specific to banks due to their activity and inherent risks. Risks and charges provisions booked are in principle tax deductible as the loss is clearly identified and either likely or certain to occur but uncertain as to the amount or to the date. Besides, country risk provisions reflecting the temporary risk of recovery due to economic/political situation of the country of the debtor are also tax deductible. A lump-sum provision for risk-weighted assets could also be booked by the banks and is tax deductible if it meets certain conditions (i.e. limitation to 1.25% of the qualifying risk weighted assets). The AGDL ("Association pour la Garantie des Dépôts Luxembourg") provision booked is also tax deductible;

- In Poland, for banks only, a general risk provision set up in accordance with Polish accounting standards, i.e., generally, a maximum of 1.5% of all outstanding loans, should in principle be tax-deductible;
- In Spain, general provisions are not tax-deductible as a rule. However, in general terms, banks can deduct the annual charge of these provisions up to the limit of 1% of the positive difference from qualifying loans granted in the year;
- In China, the general provision is tax-deductible for banks only up to 1% of the permitted scope of loan assets, subject to a special formula;
- In Singapore, with the introduction of FRS 39, general and specific provisions for bad or doubtful debts will no longer be made. Banks which do not have a robust loss estimation process and are unable to provide for collective impairment under FRS 39 are required by the banking regulator to maintain a certain level of impairment provisions. As a concession, the amount of general provisions (computed based on a provisional formula provided in the tax legislation) will be deductible. An auditor's certification is required to support the deduction claim.

3.6.2. Specific Provisions

84. **Deductibility.** Overall, in order for a provision to be tax-deductible, the majority of the survey countries require the provision to be linked to identified losses to a minimum extent, taking into account *inter alia* the probability of a certain loss, the aging of loan, payments in arrears, etc. In this respect, two countries, Spain and Switzerland (for the canton of Zurich), provide that the deductibility of such specific bad-debt provisions is generally more restrictive for banks than for other companies.

On the contrary, Portugal reported that the conditions of tax-deductibility of specific provisions are less severe for banks than for companies of other sectors, since for banks the aging of the debt is normally lower than in other companies. In the USA, too, the deductibility of specifc provisions against debt obligations is severely limited for companies other than banks.

Certain countries specify the probability of the loss by linking the percentage deductibility to the period over which the payment is overdue (such is the case in Slovakia for instance) or by requiring documentation to evidence the 'loss' of the loan (such is the case in Poland and Belgium for instance).

In the case of specific provisions, too, certain countries limit their deductibility on the basis of a certain percentage or type of loan portfolio (such as China for instance) or other parameters such as the bank's profits (such as Germany for instance), etc.

85. **General Credit Risk Provision.** In addition, certain countries also report the possibility of a provision specific to the banking sector (general credit risk provision). Overall, such specific provisions are generally recorded in accordance with special regulations and are generally considered tax-deductible in the amount stated therein (such is the case in Greece, Lithuania, Luxembourg, and

Romania for instance). Some of these have already been commented above in the section regarding the general provisions.

86. **Overview Table.** We refer to Enclosure 8 for an overview table of the tax treatment of bad and doubtful debts.

3.7. Tax Treatment of Employee Stock Option Plans

87. **No Special Tax Treatment.** Generally none of the countries cited any special tax treatment for stock option plans granted by banks as opposed to other companies.

88. **Deductibility Conditions.** The majority of the countries stated that whether payments in relation to stock option plans granted by banks are deductible depends on their tax treatment in the hands of the employee. Certain countries specified in this respect that deductibility is subject to certain conditions (such is the case with Estonia, Germany, Ireland, Malta, Slovenia, Sweden, the UK and Singapore for instance. On the contrary, this is for instance not the case in Austria), generally these conditions relate to:

- Taxation of the fringe benefit in the hands of the employee;
- Reporting requirements;
- Whether the costs are actually incurred (not in the case of a capital increase).

89. **Non-Deductibility.** Based on the input provided, these costs are not deductible for corporate income tax purposes in Denmark, the Netherlands and Slovakia.

90. **Unclear Position.** Finally, a limited number of countries, i.e. Estonia, Italy, Lithuania and China, state that their tax law leaves it unclear whether such costs can be considered as tax-deductible. Nevertheless, they say that there are arguments for claiming tax-deductibility, i.e. in relation to taxation in the employees' hands.

91. **No Deduction of Capital Losses on Shares.** In Belgium, payments in relation to stock option plans are deductible, except for capital losses on shares.

3.8. Specific Questions Regarding Banks

3.8.1. Under/Over-Estimation of Book Value – Accounting Discretion

92. **No Specific Comments.** Overall, the majority of the countries do not provide any specific comments on this question. In general, there is no difference in treatment of banks as opposed to other companies. In addition, this question relates more to applicable accounting standards than a tax issue.

93. **Exceptions.** Only an isolated group of countries report possible differences in treatment in relation to this question:

- In Austria, the law contains two provisions regarding the discretion to under-/overstate the book value of capital, i.e. (i) in relation to claims of credit institutions, securities (except for portfolio assets), loans an advances where necessary for reasons of prudence in the light of particular banking risks, and (ii) in the case of the fund for general banking risks. These accounting discretions do not qualify as tax-deductible;
- In Germany, credit institutions have the option of capitalising receivables, bonds, fixed-interest securities and other non-interest-bearing securities at a lower value than the value according to German GAAP as far as this is deemed necessary to protect against specific risks resulting from the credit institution's line of business. However, this does not entail any tax consequences.

3.8.2. Difference in Treatment Between Subsidiaries and Branches

94. **No Differences.** From a tax perspective, almost none of the countries report a difference in treatment between banks incorporated as local subsidiaries and local branches of foreign banks.

For the sake of completeness, Romanian tax law does not set down any specific rules regarding the deductibility of provisions in the case of branches. Therefore, it is assumed that (contrary to the case with subsidiaries) credit risk provisions set up according to internal group policy or IFRS should be allowed.

3.9. Practice

95. **No Specific Comments.** Generally, none of the countries report any current practice deviating from the statutory provisions.

For the sake of completeness, and as explained above, Portugal specifies that, although not explicitly provided for in its tax law, due to the specific nature of their financing activities, branches may deduct interest paid on loans received from their head office, which is not so for other branches.

4. Conclusion

96. **No Major Differences.** We found no evidence that banks have a significantly lower or higher corporate income tax burden than companies active in other sectors. As a general rule, the applicable standard corporate tax rate (including any municipal rates), computation of the tax base, deductible items or tax reliefs and so forth are generally the same for banks as for companies active in other sectors. There may be some differences specific to the bank business, but *prima facie* these differences do not appear significant.

97. **Specificities to the Bank Sector.** The differences are either justified by banks' particular business model or by the fact that they are regulated bodies given their central role in the economy. Differences such as the tax treatment of provisions on doubtful debtors or loans, the deduction of interest in branch structures, the taxation of financial instruments, as well as the fact that certain anti-abuse provisions, such as thin-capitalisation rules, are inapplicable or less-stringently applied to banks compared to other companies in certain countries, does not appear to constitute favourable tax treatment for banks. Indeed, it would appear merely to be a consequence of the fact that banks operate a unique type of business and are regulated companies already subject to strict rules in terms of capital adequacy requirements.

98. **No ETR Exercise.** In the present Study, we have not performed any exercise to analyse whether the effective tax rate on banks is or might be significantly lower or higher compared to other categories of taxpayers.

99. **Code of Conduct.** Concerning this last aspect, it is worth mentioning a recent report from the OECD Forum on Tax Administration ('FTA') relating to a 'framework for a voluntary code of conduct for banks and revenue bodies'. This Framework is based on previous OECD reports (OECD 2009: Building transparent tax compliance by banks, OECD Paris; and OECD 2008: Study into the role of tax intermediaries, OECD Paris) and describes an enhanced relationship between revenue bodies, large taxpayers and their advisers, which is a collaborative relationship anchored more on mutual trust than enforceable statutory obligations. These reports identify a number of principles that could serve to guide the relationship between banks and revenue bodies, such as that (i) banks should not become involved in aggressive tax planning either on their own behalf or in their capacity as tax intermediaries, and they should consult with revenue bodies where there is significant uncertainty, (ii) banks and revenue bodies should work towards a common view of what constitutes acceptable or unacceptable tax planning. In this respect, both South Africa and the United Kingdom have introduced measures aimed at improving the relationship with their banking sectors. The UK introduced a Code of Practice on taxation for banks on 9 December 2009. The aim of the Code is to ensure that banking groups operating in the UK comply with the spirit, as well as the letter, of the law when it comes to tax matters. This initiative is to be seen in the context of the UK tax authorities' continuing drive to improve relations with large business.

100. **Bank Levies and Compliance Costs.** Although not part of the questionnaire as drafted, and not therefore the prime purpose of the study, we felt it useful, in order to give an objective overview of taxation of the Financial Sector, to mention that, in many countries, bank levies have recently been proposed or are to be proposed in the near future. They vary from country to country (in terms of the perimeter of the levy, taxable base and rate), but in most cases are based on concepts and principles taken from the 2010 IMF report on a 'fair and substantial contribution by the Financial Sector'. Also, as such levies are currently introduced or being proposed in different jurisdictions without any consistent approach, multinational banking groups may be subject to a double imposition of tax for which

currently no relief is possible under double taxation agreements, etc. Due to the fact that for such type of tax generally no deductions, reductions or exemptions, etc. apply, such taxes may thus have an impact on overall taxes borne by banks as opposed to other companies. In addition, banks are playing a central role in collecting taxes on behalf of Governments and in reporting tax information which entails significant compliance costs. In our view, this has also to be taken into in assessing the tax treatment of Financial Institutions in general, and banks in particular.

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CHAPTER 2: Value-Added Taxation of the Financial Sector

1. Purpose and Scope of this Chapter

101. As already mentioned, the scope of this Study encompasses delivery of a review of current tax provisions directed at the Financial Sector and financial instruments in the EU's 27 Member States as well as – for comparison – some significant third countries.

102. More specifically, this Chapter covers the following questions:

1. For EU Member States, article 135(1) of Directive 2006/112/EC applies, which exempts financial services. Do similar provisions apply to the other, key third countries for VAT, sales taxes or consumption taxes of the same nature?
2. Do EU Member States use article 137(1)(a) of Directive 2006/112/EC to allow taxable persons a right of option for taxation of financial transactions referred to in points (b) to (g) of article 135(1), and if so to what extent? Do third countries have similar provisions?
3. Have EU Member States introduced taxes to specifically compensate for the general tax exemption for the Financial Sector (e.g. DK, FR payroll taxes, DE has a tax on insurance contracts similar to VAT but not allowing for deduction of input VAT, stamp duties, Contracts for Difference, etc.)?

103. The scope of this Chapter includes an overview together with a high-level description of the scope and application of the taxes identified but does not include detailed descriptions of the specifics of each tax. Where necessary, we have added whether the tax is applicable to banks, insurance companies, credit card companies or other institutions.

104. This Chapter needs to be seen as a more thorough additional step following the previous PwC study of 2006.

The 2006 study especially focused on the general economic effects of the VAT exemption of financial and insurance services in the EU25 and some third countries (based on a questionnaire of around 80 questions that was completed by the PwC Global Indirect Taxes Financial Services Network) with particular emphasis on:

- The distortions that are particular to smaller financial services firms as these thought they were facing greater pressure for outsourcing as a result of scale issues;
- The barriers to entry that result from, for instance, VAT costs associated with the outsourcing of back-office functions in the early stages of market development;
- The distortions in the European financial services sector compared to the rest of the world, where many firms benefit from a more benign tax environment.

This Chapter, on the other hand, is aimed at providing an in-depth overview of the indirect taxation of financial and insurance services within the EU27 (instead of the EU25) as well as for key third countries, with a view to examining the need to adapt tax systems so as to make the financial sector contribute to public budgets fairly and substantially. This Study is indeed triggered by the political discussions on the economic and financial crisis in the financial sector.

It focuses on the specific application of the option to tax regime set forth in article 137 (1)a of Directive 2006/112/EC, the application of similar VAT exemptions in third countries as those provided for in article 135(1), points (b) to (g) of Directive 2006/112/EC within the EU27 and the manner in which Member States have introduced other compensating taxes, levies etc. for the general VAT exemption of the financial sector in order to better understand the current taxation of the financial sector in the EU.

2. Action Undertaken

105. **Questionnaires Drafted.** To gather the necessary information on the national legislation of the EU's 27 Member States plus four identified key third countries, two different questionnaires were made up, one for the EU's 27 Member States and one for the key third countries (i.e. China, Singapore, Switzerland and the United States of America) containing the questions described above. You will find enclosed the questionnaires used for the EU's 27 Member States and the four key third countries (Enclosures 10, 11 and 12).

106. **Questionnaires Sent to PwC Network.** Subsequently, these questionnaires were sent through the PwC Global Indirect Taxes Financial Services Network in January 2011 to collect the necessary data, which was received from the Network in February 2011.

107. **Data Analysis.** Based upon the input received, a more-detailed analysis, including the necessary PwC quality checks, has been done on the data, resulting in our final outcome reported below and the attached enclosures.

3. Results

3.1. VAT, Sales Tax or Consumption Taxes of the Same Nature Applicable in Third Countries

108. **Key Third Countries Having Similar Exemption for Financial Services.** Of the key third countries, Switzerland and Singapore both have similar exemptions for financial services as laid down in article 135(1) of Directive 2006/112/EC. In Switzerland, it even seems that the Swiss Federal Tax Administration will be adopting the European Court of Justice's interpretation regarding intermediary services following the cases CSC Financial Services Ltd (C-453/05 of 21 June 2007) and Volker Ludwig (C-235/00 of 13 December 2001).

109. **No Sales Tax on Financial Services but Premium Tax on Premiums.** In the USA, a Sales Tax is imposed at State level on the supply of tangible items and some very specific services. None of the States imposes Sales Taxes on financial services as provided for in article 135(1) of Directive 2006/112/EC. However, many States levy a Premium Tax on the premiums received by insurance companies for insuring risk in that particular State.

110. **Business Tax in China but Uncertainty on Taxable Basis.** In China, financial services are generally subject to Business Tax (and not VAT). However, uncertainty arises with respect to the taxable basis on which Business Tax should be calculated (gross or net). The Chinese government is currently enacting a process of VAT reform, which may entail merging the existing Business Tax system into VAT.

111. **No option to Tax in Key Third Countries.** No "option to tax" regime similar to the provisions of article 137(1)(a) of Directive 2006/112/EC exists in Switzerland, Singapore, China or the USA.

112. **VAT Deduction Schemes for Financial Services Providers.** Singapore allows a VAT deduction for banks based upon a fixed rate depending on the type of licence the bank holds or based upon a standard input tax recovery formula for other financial institutions. Switzerland[1], China and the US, on the other hand, do not have real input tax recovery systems in place.

113. **Detailed Overview.** Please find enclosed a more-detailed overview of the VAT, Sales Taxes and consumption taxes regimes with respect to financial services in the four key third countries (see Enclosure 13).

3.2. Option to Tax Financial Services in the EU Member States

114. **Possibility to Opt for Taxation of Exempt Financial Transactions.** According to article 135(1)(a) to (g) of Directive 2006/112/EC, financial services are VAT-exempt. Nevertheless, article 137(1)(a) of Directive 2006/112/EC gives EU Member States the possibility to allow taxable persons a right to opt for taxation of exempt financial transactions as mentioned in article 135(1)(b) to (g).

115. **Only Option to Tax in Seven Member States.** This means that the EU Member States may at their own discretion implement the option to tax financial services, except insurance transactions. However, of the 27 EU Member States, only seven have implemented a provision for the option to tax financial services: Austria, Belgium, Bulgaria, Germany, Estonia, France and Lithuania.

116. **No Option to Tax in Other Member States in the Near Future.** Currently, no other EU Member States are considering implementing this provision in the near future. Only in Latvia and Cyprus are initial discussions on-going with regard to a future possible implementation of the option to

[1] In order to reduce administrative cost the Swiss Federal Tax Administration offers insurance companies and banks industry-specific lump-sum methodologies as a partial exemption method via an administrative guidance.

tax. However, at this stage it is too early to say whether these Member States will finally adopt the "option to tax" provision.

117. **Option to Tax Not Limited to Financial Institutions.** In most of the EU Member States, the option to tax is not limited to financial institutions.

118. **Significant Divergences In Scope and Application of Option to Tax.** The scope and application of the option to tax diverge significantly from one EU Member State to another.

119. **Divergences Regarding Extent of Option to Tax.** Austria, Belgium and Bulgaria have implemented the option to tax to a very limited extent, while other countries like Germany,[2] Lithuania[3] and Estonia[4] have implemented it for almost all exempt financial services within the scope of article 135(1) of Directive 2006/112/EC. France, on the other hand, has implemented the option to tax for all transactions relating to banking and financial activities and, in general, to trading in securities and money. However, the actual application is limited as several, specific financial services are excluded from the scope of the option.

120. **Divergences Regarding Conditions.** The specific conditions for exercising the option also differ among the relevant EU Member States.

121. **Divergences Regarding VAT Status of the Customer.** In Germany and Lithuania, the option can only be exercised if the customer is a vatable person whereas the other EU Member States do not differentiate how it can be applied on the basis of the status of the customer.

122. **Divergences Regarding Exercising of the Option.** In France, once exercised, the option applies to all eligible services. In Lithuania, the option applies to a specified group of financial services and in Belgium to all payment and receipt transactions. In Austria, Bulgaria, Germany and Estonia, the option can be exercised on a transaction-by-transaction basis.

123. **Divergences Regarding Territoriality.** There are also differences with respect to the territoriality. In general, the option to tax is not applicable to cross-border transactions or the conditions are so strict that they preclude use of the option to tax. In Belgium and France, the vatable person opting to tax will have a right to deduct VAT with respect to cross-border banking and financial transactions, even if the service is exempt of VAT in the EU Member State of the recipient.

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[2] Germany: implemented the option to tax for the services mentioned in article 135(1)(b) to (f) of Directive 2006/112/EC.
[3] Lithuania: implemented the option to tax for the services mentioned in article 135(1)(b) to (f) of Directive 2006/112/EC.
[4] Estonia: implemented the option to tax for the services mentioned in article 135(1) (b) to (g) of Directive 2006/112/EC.

124. **Option to Tax Not Commonly Used.** With respect to the use of the "option to tax system" by the operators (i.e. financial institutions), it seems that the option to tax is not commonly used in most of the relevant EU Member States and is certainly not widespread within the Financial Sector

125. **Detailed Overview Enclosed.** Please find enclosed a more-detailed overview of the option to tax regimes in Austria, Belgium, Bulgaria, Estonia, Germany, France and Lithuania (see Enclosure 14)[5].

3.3. Other Taxes Compensating for the General Tax Exemption

126. **Other Taxes on Financial Transactions But Not All Compensating.** Nearly all EU Member States have introduced other taxes on financial transactions. Nevertheless, these do not all have the goal of specifically compensating for the VAT exemption for financial services. Most taxes were already levied before the implementation of VAT. Only six EU Member States do not have any other taxes on financial services (Slovakia, Romania, Poland, Lithuania, Estonia and the Czech Republic).

127. **Specific Payroll Taxes in France and Denmark**. France and Denmark have introduced payroll taxes to be paid on salaries by employers with VAT-exempt financial or outside-scope activities. The payroll taxes are apportioned on the basis of a *pro rata* taking into account the VAT-exempt and outside-scope turnover and are clearly a VAT-compensatory tax.

128. **Insurance Premium Tax in Most EU Member States but Divergence in Scope and Application.** Nineteen EU Member States (Austria, Belgium, Bulgaria, Cyprus, Germany, Denmark, Spain, Finland, France, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Slovenia, Sweden and the UK) have an insurance premium or similar tax, a government levy on insurance contracts/companies. The scope and application of insurance premium tax differ from one EU Member State to another. In some EU Member States, this tax is clearly a VAT-compensatory tax while, in other countries, this link cannot be made. According to the latest information, the Czech Republic may implement an insurance premium tax in 2013.

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[5] Although not within the scope of this particular study, we would draw attention to the fact that distortions of competition in the Financial Sector within the EU 27 Member States and vis-à-vis third countries is caused not only by the divergence in application of the option to tax rule amongst Member States but also to:

- divergent interpretations of the VAT definitions of exempt financial services as stated in article 135(1) of Directive 2006/112/EC,
- divergent interpretations of ECJ case law:
  e.g. ECJ (C-242/08) Swiss Re concerning the proper VAT treatment of the transfer of a portfolio of reinsurance contracts by a German reinsurer to a Swiss associate. Although the Court clearly stated that these transactions are vatable, in practice, some Member States still treat them as VAT-exempt transactions due to their conferring a broader interpretation on other VAT exemptions, while other Member States consider them as vatable. These divergent interpretations of common transactions, for example within the insurance world (such as transfers of insurance portfolios, claims-handling transactions, run-off services or insurance back-office services) create distortion of competition not only within the Member States but also vis-à-vis third countries.
- inconsistent implementation of the VAT prorate methodology between Member States;
- inconsistent implementation and interpretation of the cost-sharing VAT exemption and VAT grouping rules in some Member States.

129. **Also Other Taxes and Levies on Financial Instruments.** Alongside these taxes, most countries have also implemented other taxes and levies on financial instruments/services such as stamp duties, stock exchange taxes, bank levies, special contribution taxes, government levies, registration taxes, mortgage taxes, etc. However, these taxes mostly differ from Member State to Member State.

130. **Detailed Overview.** Please find enclosed a more-detailed overview of the other taxes in the 27 EU Member States (see Enclosure 15).

131. **Recent Introduction of New Taxes in Several Member States.** Some Member States have recently introduced new taxes or have intentions of implementing new taxes or adapting existing taxes. This is the case for Austria, Belgium, Bulgaria, the Czech Republic, Greece, Hungary, Ireland, Poland, Romania and the UK.

4. Conclusion

132. **Taxation of Financial Transactions in Key Third Countries.** Of the key third countries, Switzerland and Singapore both have similar exemptions without credit for financial services as laid down in article 135(1) of Directive 2006/112/EC. In the USA, no sales taxes are levied on financial services. However, most States levy an insurance premium tax. In China, on the other hand, financial services are generally subject to Business Tax.

133. **No Option to Tax in Key Third Countries.** No "option to tax" similar to the provisions of article 137(1)(a) of Directive 2006/112/EC exist in Switzerland, Singapore, China or the USA.

134. **VAT Deduction Schemes for Financial Services Providers.** Singapore provides for input VAT deduction based upon a fixed rate depending on the type of licence the bank holds or based upon a standard input tax recovery formula for other financial institutions. Switzerland, China and the US do not have real input tax recovery systems in place in their tax legislation.

135. **Only Option to Tax in Seven Member States but Significant Divergences in Scope and Application.** Within the EU's 27 Member States, only seven Member States have implemented a provision for opting to tax financial services. The scope and application of the option to tax diverge significantly from one EU Member State to another. With respect to actual use, it seems that the option to tax is not commonly used in most of the relevant EU Member States and is certainly not widespread within the Financial Sector.

136. **Other Taxes on Financial Transactions but Not All Compensating.** Nearly all EU Member States have introduced other taxes on financial transactions. Nevertheless, they do not all have the goal of compensating for the VAT exemption for financial services. The most common additional tax on financial services is insurance premium tax. Most EU Member States have also implemented other

taxes and levies on financial instruments/services such as stamp duties, payroll taxes, stock exchange taxes, bank levies, special contribution taxes, government levies, registration taxes, mortgage taxes etc. However, these taxes mostly differ greatly from EU Member State to EU Member State.

137. **Recent Introduction of New Taxes in Several Member States.** Some Member States have recently introduced new taxes or have intention of implementing new taxes or adapting existing taxes.

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CHAPTER 3: Labour Taxation in the Financial Sector

1. Purpose and Scope of this Chapter

138. The scope of this Chapter extends to identifying whether and, if so, to what extent salaries and incentive pay schemes paid to employees in the Financial Sector are treated differently for income tax, social security and any other applicable salary tax purposes than salaries paid to employees working in other sectors. It clarifies the conditions under which this differentiated treatment applies, if any, and explains its rationale. It identifies whether dividend income and capital gains on shares issued by a financial institution might be treated differently for an individual shareholder than dividend income and capital gains on shares issued by non-financial organizations.

139. The scope of this Chapter does not include a description of the tax and social security treatment of salaries and incentive pay schemes in the different jurisdictions but aims at identifying and understanding of whether and, if so, to what extent differentiated tax treatment applies to pay in the Financial Sector. The scope of this Chapter also does not include a review of pay practices, pay structures and pay levels in financial services by comparison with those applicable in other sectors. The scope of this Chapter does not necessarily address the impact that regulatory requirements specifically applicable to the Financial Sector might have on pay practices in the Financial Sector.

140. For the purpose of this Chapter, the "Financial Sector" includes banks, insurance companies, credit card companies, stock brokers and management companies of investment funds. Investment funds themselves have not been included. Investment funds are managed by dedicated management companies and are therefore generally not staffed.

2. Action Undertaken

141. As agreed, to ensure a consistent approach in each jurisdiction, we have prepared a questionnaire including 7 questions. This questionnaire (see Enclosure 16) was included in the contract referred to above and agreed by the Commission.

142. Further to our interim report, you have raised specific questions for Denmark, France, Ireland, Italy, Portugal and the UK in your e-mail of February 14, 2011. In addition, further to the telephone conversation of February 23, 2011, during which we discussed the way forward to the interim report, we have prepared and sent additional questions to each jurisdiction. This additional questionnaire is attached (see Enclosure 17). The aim of this additional questionnaire was to gather information on whether pay packages in the Financial Sector include a proportion of components benefiting from favourable tax treatment (like equity incentive elements) different from the proportion of such

components included in pay packages in other sectors so that the average tax burden on pay packages in the Financial Sector might be lower than in other sectors.

3. Results

3.1. Identification of a Possible Differentiated Tax Treatment of Salaries and Incentives Applicable in the Financial Sector in Comparison to Other Sectors

3.1.1. For Individuals

143. **Identification of Differentiated Tax Treatments.** Based on the answers provided by our offices in the various jurisdictions, out of a total of 31 countries (27 EU Member States, China, Singapore, Switzerland and the USA) only 7 countries have reported having taken legal initiatives according to which salaries, bonuses, stock options, and/or other equity incentives in the Financial Sector have been, are or are expected to be treated differently from a tax perspective from those in other sectors.

Those countries are:

- France
- Greece
- Ireland
- Italy
- Malta
- Portugal
- United Kingdom

144. **Danish Special Payroll Tax.** For the sake of completeness, it should be noted, however, that Denmark reported that companies not subject to VAT (irrespective of the sector of activity) are liable to a special payroll tax of approximately 9% levied on total salaries. Board member fees are not subject to this special payroll tax. As organizations in the Financial Sector are not subject to VAT in Denmark, they are liable to this payroll tax. However this 9% payroll tax is not specific to organizations in the Financial Sector, it also applies to other organizations not subject to VAT (as of 1 January 2011, the size of the levy has been increased from approximately 9% to 10.5%). Based on the above, it therefore may not be concluded that this payroll tax only actually burdens pay in the Financial Sector, although this is effectively the case.

145. **Dividends and Capital Gains.** Furthermore, dividend income and capital gains on shares issued by companies in the Financial Sector are not treated differently from dividend income and

capital gains on shares issued by companies in other sectors. Therefore, even if organizations in the financial services were to resort to equity incentives (stock options, etc.) more intensively than organizations in other sectors, the reason may not be that there is differentiated tax treatment of dividend or capital gains on shares between the Financial Sector and other sectors. Governments have not thus encouraged more intensive use of incentives, if there are any, in the Financial Sector by means of a favourable tax treatment of dividend income or capital gains on shares in the Financial Sector.

146. Below we describe the aforementioned differentiated tax treatments in these 7 jurisdictions.

3.1.1.1. France

147. France introduced a temporary 50% tax on 2009 bonuses granted to employees working in the financial trading market and whose activities were likely to have a material impact on the risk exposure of banks and investment companies. In particular, traders and sales were concerned, as well as individuals operating in the financial markets and managing traders and sales. Board members not acting in the financial markets in the course of their business were not concerned by this tax. As the tax applied only once (to bonuses paid in 2010, which were calculated on the basis of the performance of the employee in 2009), bonuses paid in 2011 on the basis of 2010 performance will no longer be subject to this tax.

148. The tax was levied on the variable part of remuneration exceeding EUR 27,500 and allocated based on individual or collective performance for the year 2009 (excluding the mandatory and voluntary profit-sharing schemes regulated by the French Labour Code). The tax was due even if final vesting of the bonus or its payment was subject to certain conditions, and the amount of the tax was not adjusted/refunded based on the actual payouts.

149. Variable compensation paid either in cash or via the grant of free shares, stock options or other securities granted under preferential conditions fell under the scope of the tax. When equity instruments were used, the fair value, as determined according to the international accounting standards (IFRS2), was used as the taxable basis.

150. It is the employer who was liable to this 50% one-off tax surcharge just as if it were a special 50% employer social security tax. This special tax surcharge was due in addition to other taxes normally applying to bonuses and was thus notably subject to individual income tax at rates of up to 41% for 2010 income.

3.1.1.2. Greece

151. According to article 14, par. 9, of the Income Tax Code, bonuses that are paid beyond regular remuneration and overtime payments up to 31 December 2013 by credit institutions to their corporate officers (chairman, members of the board of directors, managing or executive directors, administrators,

directors etc.) are liable to a special tax according to the following terms and conditions. This rule applies irrespective of whether the bonus is paid in cash or in shares.

152. If the total pay of the recipient does not exceed EUR 60,000 per annum, bonuses in excess of 10% of total pay are subject to tax at the following rates:

- Up to 20,000 EUR 50%
- 20,001-40,000 EUR 60%
- 40,001-60,000 EUR 70%
- 60,001-80,000 EUR 80%
- 80,001 EUR and over 90%

153. This tax scale applies to the excess mentioned above instead of the regular tax scale, which provides for a maximum top marginal rate of 45%. If total pay exceeds EUR 60,000, bonuses in excess of EUR 6,000 are taxed based on the same tax scale.

154. As a result, bonuses paid to corporate officers of credit institutions may suffer tax at a rate of up to double the regular top marginal rate of 45%.

155. The rationale for this differentiated treatment is that it is deemed necessary to tax excessive bonus amounts paid to corporate officers of credit institutions in light of the financial crisis that Greece is currently experiencing.

3.1.1.3. Ireland

156. A 90% tax rate called the “excess bank remuneration charge” was introduced on 1 January 2011 on all emoluments/remuneration which are not regular remuneration i.e. any element of remuneration that varies by reference to performance of the business or the individual e.g. bonuses.

157. The 90% charge will apply to employees of specified financial institutions that are covered under the State Guarantee Scheme (“covered institutions”) who are Irish tax-resident or who exercised the duties of their employment wholly or partly in Ireland during the tax year in which the payment was made.

158. Further to this, the “excess bank remuneration charge” has the following characteristics:

- It does not apply where the 'relevant remuneration' is less than €20,000 in the tax year;
- There are rules to determine the value of the award if it is not in cash or is subject to restrictions;
- The charge will be effected by means of the new Universal Social Charge, but at a special rate of 45% (the sum of the top income tax rate of 41%, social security of 4% and the penalty USC of 45% comes to the said 90%);
- The employer will be obliged to withhold the charge at source;

- There are various new reporting requirements.

159. To determine whether board members are considered as employees in scope of this "excess bank remuneration charge", a distinction has to be made between executive and non-executive board members.

160. While there might be some argument as to whether executive directors are caught (if they don't have an underlying employment contract alongside their directorship), it is clear from all public statements that the intention is to bring executive directors within this legislation. Furthermore, regulations are expected which will probably put that aspect beyond doubt.

161. In relation to non-executive directors, it appears they probably fall outside the legislation. However, non-executive directors are largely government-appointed to the institutions in question. Furthermore, we expect their directors' fees are not performance-related, meaning they should not be classed as 'relevant remuneration' for the purposes of this legislation.

3.1.1.4. Italy

162. According to Law Decree n° 78 dated May 31, 2010, converted with modifications into Law n° 122 dated July 30, 2010, bonuses and stock options granted to executives of companies operating in financial services will in principle be subject to a tax surcharge of 10%, applicable only to the extent that they exceed 3 times the base salary of the beneficiary. Board members are considered as executives for the purposes of this special bonus tax.

163. The Italian tax authorities have not yet issued a "guideline" providing the necessary clarifications on this recent tax rule. However, considering that the top marginal tax rate for individual taxpayers is equal to 43%, the amount of bonus and stock options exceeding 3 times the individual's base salary would be subject to a tax rate of 53% instead of 43%.

164. At this stage it is unclear whether, with respect to stock options, this excess will be measured at the grant date of the options or when the options are exercised.

3.1.1.5. Malta

165. Expatriates (as defined in the law and satisfying certain determined conditions) working in investment services6 and insurance companies are not taxable on certain limited expenses and other

[6] For income tax purposes, article 6 of the Income Tax Act defines *"investment services expatriate"* as: *"any individual who is an employee of, or provides services to, an investment services company which holds an investment services licence issued under article 6 of the Investment Services Act or a company which is recognised by the relevant competent authority for the purposes of article 9A of that said Act, and whose activities solely comprise the provision of management, administration, safekeeping or investment advice to collective investment schemes as defined in the aforesaid Act."*

emoluments for a limited period of time, e.g. removal costs in respect of relocation to or from Malta, accommodation expenses incurred in Malta, travel costs in respect of visits by the investment services expatriate or insurance expatriate and his immediate family to or from Malta. Furthermore they are treated as non-residents for certain purposes of the Income Tax Act and thus are taxed on their Maltese-source income only.

166. Expatriate employees of investment services firms holding a licence to provide these services are exempted from social security contributions provided they satisfy certain strict conditions, e.g. are engaged in a managerial capacity or in a function requiring special expertise which is not generally available in Malta, their mission in Malta is of a temporary nature and they have maintained the centre of their economic interests outside Malta. However, due to the strict conditions which are applicable, this exemption is of limited application in practice.

167. As Malta has severe restrictions and limitations of expertise in this sector, these tax concessions aim at attracting to Malta people from abroad with expertise in some specialised areas of financial services, so that they can provide the benefit of their expertise and train locals.

3.1.1.6. Portugal

168. For a long time the banking sector has had a special social security system, which was applicable under the same conditions to board members and other employees from the banking sectors and which did not provide for any limitation on the contribution basis. This regime has been adapted to bring it closer to the general social security regime.

169. Employees in the banking sector hired after March 2009 are subject to the general mandatory social security system (old age pension and disability coverage), but they still benefit from the entitlement to banking sector health assurance.

170. As from 1 January 2011, employees in the banking sector hired before March 2009 have also become subject to the general social security regime for retirement pensions but they maintain the same level of contributions and their guaranteed rights (e.g. a pension calculated in accordance with the rules applicable to the pension fund). However, a retirement pension cannot be lower than the amount set in the collective agreement applicable to the bank sector.

171. The legislation does not say whether, as from 1 January 2011, board members in the banking sector will be enrolled in the special regime for board members or be subject to the same rules applicable to other banking employees.

172. The Portuguese social security legislation provides for a special social security regime for board members, according to which they are subject to lower social security rates and have a capped contribution basis (maximum monthly contributions basis of EUR 5,030.64).

173. Additionally, banks do not have yet guidelines on social security in relation to this issue and each bank is using the regime that it understands to be the most appropriate. Taking into consideration the impact of this issue, it is expected that the Portuguese social security authorities will take a position on this soon.

174. Since 2010, executives' and board members' variable pay in excess of 25% of total annual remuneration and EUR 27,500 has been subject to a special autonomous tax levied at a rate of 35% except if at least 50% of the variable pay is deferred over a 3-year period and is contingent on corporate performance over the deferral period. In the Financial Sector, the 35% rate has been increased to 50% effective in 2010. Since January 2011, the autonomous corporate tax has also been charged at the rate of 35% in the Financial Sector.

175. The special autonomous tax is a tax due by the employer, not by the employee. The bonus still remains subject to regular social security charges and personal income tax.

3.1.1.7. United Kingdom

176. The UK government introduced a one-off bank payroll tax of 50% applicable in 2010 on certain bonuses and other payments that met certain conditions, payable by the employer and not the employee.

177. The payroll tax was an employer's liability that came on top of the income tax due by the employee.

178. As an example, on a gross bonus of 100,

- Employer bank payroll tax = 50 (not deductible for corporation tax)
- Employer national insurance = 12.8
- Employee tax and national insurance = 41 (as generally applicable to bonuses paid when top rate of tax and employee national insurance was 41%).
- Net bonus for the employee = 59

179. This one-off payroll tax of 50% aimed to alter the behaviour of banks to get them to reduce the level of bonuses paid, which it failed to do. In general banks did not reduce the level of bonuses but paid the 50% if applicable.

180. There is no current intention to adopt a similar measure in the future.

3.1.2. Availability of a Corporate Tax Deduction of Pay

181. **Corporate Tax Deduction of Pay.** As we suggested in the interim report, we have investigated for each of the 31 countries whether there is differentiated corporate tax deductibility of costs of pay (for both board members and non-board members) in the Financial Sector in comparison with other

sectors. This could be a determinant factor in the determination of the existence of differentiated tax treatment overall.

182. However, as we anticipated, **out of the 31 countries, each one confirmed that the costs of pay are deductible for corporate tax purposes to the same extent in the Financial Sector as in other sectors**. This is not to say that each component of pay packages qualifies for a corporate tax deduction but it does mean that the eligibility of any given component included in a pay package for a corporate tax deduction is not different according to whether it is allotted by organizations in the Financial Sector or in other sectors of activity.

3.1.3. Conclusion

183. **Temporary Measures.** In 2010, France and the UK introduced a one-off 50% payroll tax on certain categories of bonuses payable in organizations in the Financial Sector. This 50% payroll tax, payable by the employer, is no longer applicable. Also in 2010, Portugal laid down an autonomous corporate tax on bonuses and other variable remuneration paid to executives or board members, which was charged at the rate of 50% in the Financial Sector and at the rate of 35% in other sectors. However, since January 2011, the autonomous corporate tax has also been charged at the rate of 35% in the Financial Sector.

184. **Tax Surcharge on Bonuses.** For now, we have identified that it is only in Italy and Greece that bonuses in the Financial Sector are subject to a tax surcharge while in Ireland a 90% tax is expected to apply to future bonus payments to senior executives in the banking sector (essentially banks covered by the bank guarantee scheme), effective on January 1, 2011.

185. **Malta Incentives for Expatriates.** We have also identified that in Malta there are some tax concessions applicable to expatriates active in investment services and insurance companies for the purpose of developing these activities in Malta, while in Portugal, there are some discrepancies in the social security scheme applicable in the banking sector. At this stage it is unclear which social security regime, the general one or the one prevailing in the Financial Sector, is more favourable.

186. **Summary.** Out of a total of 31 countries only 7 have reported having adopted specific legislation for the purpose of creating a differentiated tax treatment of remuneration in the Financial Sector. Most of these legal initiatives were adopted after the financial crisis and most of them resulted in a tax surcharge being applied to bonuses. However only three, being Greece, Italy and Ireland, are still applying or are about to apply a tax surcharge on “excessive” bonuses in the Financial Sector. These three countries are those which were/are being particularly hit by the financial crisis. From a corporate tax perspective, all the surveyed countries confirmed that no differentiated corporate tax deductibility of pay-related costs applied or was expected to apply in the Financial Sector.

3.2. Identification of a Possible Favourable/Differentiated Tax Treatment of Pay Packages in the Financial Sector due to a Potential Intensive Use of Equity Incentives

187. **Absence of Specific Tax Concessions.** As stated above, except for 7 jurisdictions, no specific legal initiative has been adopted by lawmakers in the EU or other surveyed jurisdictions in order to create a tax surcharge or tax alleviation on pay in the Financial Sector.

In the 7 jurisdictions where legal initiatives were taken, they were adopted following the financial crisis to increase the tax cost burdening variable pay for the purpose of discouraging the payment of excessive bonuses that could notably incentivize their beneficiaries to take risks exceeding the general level of risk tolerated by the financial organization.

Furthermore we found no evidence that, prior to the financial crisis, lawmakers in the 31 surveyed jurisdictions adopted any specific tax concessions or surcharges exclusively applicable to pay in the Financial Sector.

188. **Impact of the Pay Structure.** As a way forward to these findings, we assessed whether assuming that pay structures in the Financial Sector do depart from pay structures in other sectors, such differences might have resulted in the Financial Sector having indirectly taken advantage of possible tax concessions applicable to specific pay components - like equity incentives.

Indeed, if the Financial Sector had aligned the design of its pay practices to the increasing expectations of its shareholders (i.e. high returns in the short term) more rapidly than other sectors by means of intensive use of equity incentives then, subject to equity incentives being eligible for specific tax concessions, one might wonder whether pay packages in the Financial Sector have to that extent been treated more favourably than in other sectors.

189. **Impact of Other Regulations.** It is also interesting to note that several regulators (notably the Committee of European Banking Supervisors (CEBS)) have recently indicated that although the causes of excessive risk-taking in the banking sector are many and complex, inappropriate remuneration structures including incentives to take risks exceeding the general level of risk tolerated by a financial institution (like stock options) could have undermined sound and effective risk management and exacerbated excessive risk-taking behaviours. Hence, on that basis, one might wonder whether tax concessions, if any, applicable to such incentives could also have indirectly exacerbated excessive risk-taking in the banking sector.

190. **Stock Options and Other Equity Incentives.** To appreciate this, we have identified the jurisdictions applying favourable individual tax treatment to stock options and other equity incentives, and whether such favourable tax treatment was conditional.

Out of 31 countries, 12 have reported applying conditional favourable tax treatment to stock options and other equity incentives (being Austria, Belgium, Denmark, Estonia, France, Ireland, Poland, Spain, the UK, China, Singapore and the USA), Malta and Romania have reported applying favourable individual tax treatment to stock options only (conditional in Romania, unconditional in Malta) while Finland and Slovenia have reported applying a conditional favourable tax treatment to equity incentives other than stock options.

191. **No Differentiated Treatment.** We further surveyed the 31 jurisdictions on whether this applicable favourable tax treatment, where applicable, was open to every sector of activity or whether there were specific tax concessions applying to equity incentives in the Financial Sector. All jurisdictions that reported applying favourable individual tax treatment to equity incentives confirmed that there was no differentiated treatment in this respect between the Financial Sector and other sectors.

192. **Use of Equity Incentives.** If we make the assumption that organizations in the Financial Sector have resorted more intensively to equity incentives than organizations in other sectors, then it might, at first sight, be speculated that, in surveyed jurisdictions that reported tax concessions that were applicable to equity incentives, the Financial Sector benefited more from these tax concessions.

However, you will recall that, in a total of 16 jurisdictions that reported tax concessions applicable to equity incentives, all, except Malta, reported that such tax concessions were conditional. In this respect, our experience is that the conditions to which such tax concessions are applicable generally require that pay-outs derived under equity incentives do not exceed a certain threshold or require that the instruments (options, shares, etc.) should be held for a minimum period of time. This is interesting to note for two reasons.

Firstly, what might in the first instance appear to be a favourable tax treatment may ultimately be fair tax treatment given the restrictions applying to equity incentives. This will specifically be the case when options may not be exercised or shares sold for an agreed period of time. In that case, the fact that the taxable amount or the tax rates might be discounted would just reflect the illiquidity of the incentive and the risk taken by the beneficiary (i.e. risk of depreciation of the share) over the agreed holding period.

Secondly, in the case where the application of favourable tax treatment to equity incentives is subject to the employee satisfying holding periods of the instruments, then such tax concessions have more likely supported a better alignment of the employee's financial interests to those of shareholders in the long run and discouraged excessive risk-taking in the short run.

Although we have not analyzed the conditions under which incentives could benefit from a favourable tax treatment in each of the 16 countries, based on our experience, it is thus very unlikely that such tax

concessions have actually supported excessive risk-taking and one could even conclude that the opposite is the case.

We finally surveyed each jurisdiction on whether it was their experience that equity incentives were more intensively used in the Financial Sector than in other sectors. It was not the experience of our local offices that it was local practice but we may anticipate it could be the case.

4. Conclusion

193. **Legal Initiatives Taken in 7 Countries to Create a Differentiated Tax Treatment of Pay in the Financial Sector**. Based on the above, we found no evidence that, prior to the financial crisis, lawmakers in the 31 countries adopted any specific tax concessions or surcharges exclusively applicable to pay in the Financial Sector. By contrast, following the financial crisis we identified legal initiatives in 7 jurisdictions aimed at containing the level of variable pay by means of the assessment of tax surcharges. However only three, being Greece, Italy and Ireland, are still applying or are about to apply a tax surcharge on "excessive" bonuses in the Financial Sector.

194. **Conditional Favourable Tax Treatment of Equity Incentives Likely Discourages Excessive Risk-taking in the Short Run.** We obtained no evidence from our foreign offices that the Financial Sector more intensively resorted to equity incentives in its pay packages but we can speculate that it may possibly have been the case. This may be further investigated if needed. However, even if this has been the case, the mere fact of identifying that equity incentives benefit from a specific tax concession will not necessarily have led to an alleviation of the tax burdening pay in the Financial Sector given that, in almost all jurisdictions, such tax concessions are conditional. In addition, the conditions under which favourable tax treatment for equity incentives is available are generally of such a nature as to promote better alignment of the employee's financial interests and those of shareholders in the long run and to discourage excessive risk-taking in the short run.

195. **Equity Incentives Which Might to a Certain Extent Have Encouraged Excessive Risk-taking Prior to the Financial Crisis Now Expected to Discourage Such Behaviour.** It should be noted that, following the adoption of CRD III, the Committee of European Banking Supervisors adopted Guidelines on Remuneration Policies and Practices to ensure that remuneration policies and practices in credit institutions and investment firms are consistent with and promote sound and effective risk management. It is interesting to note that, under the CEBS guidelines, financial institutions hit by CRD III will actually have to intensively resort to equity incentives for the purpose of complying with deferrals and retention requirements applicable to variable pay. Equity incentives which might to a certain extent have encouraged excessive risk-taking prior to the financial crisis are thus now expected to discourage such behaviour. This shows that how a reward strategy may influence behaviour

does not so much lie in the kind of instruments included in the pay package but whether appropriate restrictions and conditions apply to such instruments.

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CHAPTER 4: Taxation of Financial Instruments

1. Purpose and Scope of this Chapter

196. The "Taxation of Financial Instruments" is the fourth Chapter of this Study. More specifically, this Chapter covers the following questions:

A. Securities transactions taxes

1. Are there securities transactions taxes on transfers of financial instruments?
2. What securities are in scope and which are exempt?
3. What are the tax provisions (reference to applicable tax section)?
4. Tax base?
5. Tax rate?
6. Is there a maximum amount of tax due?
7. Tax event? What is the territorial scope (e.g. place of taxable transaction, connecting factor for the transaction)?
8. Who is liable for levying the tax? Who is liable to support the tax?

B. Corporate income tax treatment of equity swaps

1. Does the general tax regime apply or are there specific tax rules applicable to swap transactions (where both parties are companies in the Financial Sector)?
2. Is there a difference if one or both of the counterparties are companies in the non-Financial Sector?
3. Are the flows of payments received taxed, if yes, when and how?
4. Are the flows of payments made tax-deductible, if yes, when and how?
5. Is there a WHT on payments to non-residents under the swap? If so, what is the connecting factor to the tax jurisdiction for the tax?
6. Is there a WHT on payments to non-residents on the sale of a swap? If so, what is the connecting factor to the tax jurisdiction for the tax?
7. How are the payments for both questions 5 and 6 above classified under the double tax treaties (other, capital gain, etc.)? Does the classification depend on the nature of the underlying?

C. Corporate income tax treatment of financial futures

1. For financial futures, does the general tax regime apply or are there specific tax rules applicable to financial future transactions (where both parties are companies in the Financial Sector)?

2. Is there a difference if one or both of the counterparties are companies in the non-Financial Sector?
3. Are gains and losses taxed, and if yes, when and how?
4. Is mark-to-market applied?
5. Is there a WHT on payments to non-residents upon the expiration of the futures? If so, what is the connecting factor to the tax jurisdiction for the tax?
6. Is there a WHT on payments to non-residents on the sale of futures? If so, what is the connecting factor to the tax jurisdiction for the tax?
7. How are the payments classified for both questions 5 and 6 above under the double tax treaties (other, capital gain, etc.)? Does the classification depend on the nature of the underlying?

D. Corporate income tax treatment of call options in general

1. Does the general tax regime apply to call options on stocks or are there specific tax rules applicable to call options on stock transactions (where both parties are companies in the Financial Sector)?
2. Is there a difference if one or both of the counterparties are companies in the non-Financial Sector?

E. Corporate income tax treatment of call options on stocks in the hands of the holders

1. For holders, is the premium paid deductible, and if yes, when (acquisition, exercise or upon expiration) and how?
2. Is there a difference if the holder is a bank/insurance company or a company active in the non-Financial Sector?
3. Is the premium paid part of the stock acquisition price?
4. Please describe the tax treatment of the gains or losses realised at the following events:
   (i) disposal of the options,
   (ii) exercise of the options,
   (iii) sale of the shares acquired through the option,
   (iv) expiration of option (without exercise or disposal)
5. Is mark-to-market applied?
6. Is there a WHT on premiums to non-residents?
7. How are the premium payments classified under the double tax treaties?
8. How are options treated when they are part of a packaged product (e.g. equity linked note)?

F. Corporate income tax treatment of call options on stocks in the hands of the writers

1. For writers, is the premium received taxable, and if yes, when and how?
2. Is there a difference if the writer is a bank/insurance company or a company active in the non-Financial Sector?
3. Is the premium received part of stock delivery price?
4. Are gains and losses upon exercise taxed?
5. Is mark-to-market applied?

G. Differentiation

For all the questions above would your answers be different according to whether the (financial) institution is a domestic one or a subsidiary or a branch of a non-domestic (financial) institution?

H. Practices

For all the above conditions is there any information as whether actual practices may differ from legal provisions?

197. The main purpose of this Chapter is to trace differences in tax treatment in relation to securities transactions as well as some selected derivatives transactions (i.e. equity swaps, financial futures and call options on stocks) amongst the different EU Member States and selected third countries, on the one hand, and between financial institutions and "normal" companies, on the other hand. To this end, this Chapter provides a general overview of the main tendencies in tax treatment common to all countries or, where relevant, some interesting exceptions to our general observations. However, it does not exhaustively summarise and detail all of the sub-questions addressed in the questionnaire.

For a thorough, detailed overview of the applicable tax regime, rules or practice in a given country, we refer to the completed questionnaires as enclosed to this Study. In this respect, we would like to point out that the answers received in the questionnaires are high-level and not exhaustive. It goes without saying that, where derivative instruments are involved, in practice, a separate analysis should be done in each case taking into account all specific facts and circumstances.

198. Furthermore, it should be stressed that this is a taxation study. The accounting treatment of the selected derivatives is not in scope of the Study and has not therefore been examined. Therefore, we did not consult our international network with specific questions on the accounting treatment of the selected derivatives. We are of course aware that the accounting treatment of a financial instrument often plays an important role when determining its tax treatment and cannot be entirely left out of consideration. In this context, we considered it necessary to devote a few brief words to some general accounting principles that could have an influence *inter alia* on the timing of the tax treatment. Please

note, however, that the insights regarding the accounting principles mentioned in this Study are merely intended to illustrate the role of the accounting treatment where derivative instruments are concerned. In this context, our comments on accounting law are for information purposes only.

2. Action Undertaken

199. To gather the necessary information, we sent a questionnaire with the above questions to our contacts in the 27 EU Member States and the four identified third countries. Based upon the input received, a more-detailed analysis including the necessary PwC quality checks has been done on the data, resulting in our final outcome, reported in Section 3 of this Chapter. For the sake of completeness, we also enclose the completed questionnaires.

200. Further to the additional questions raised on 18 May 2011 by the Commission in the framework of the review of the interim report, an additional questionnaire has been sent to our colleagues in the various jurisdictions.

3. Results

3.1. Indirect Taxation – Securities Transaction Taxes

201. **Definition**. Securities transaction taxes can be defined as "taxes imposed on the transfer of a financial instrument/security from one owner to another". This definition shows that there should be at least a "transfer" and that this transfer should relate to a "financial instrument" or a "security" (and not, for example, real estate). Since this type of tax targets the transfer of financial instruments and not the income/gain derived from such a transfer, it can be categorised as an indirect tax as opposed to a direct/income tax. Strictly speaking, it is not the same as a registration tax, as it is not directed at registration of the financial instrument. Also, a distinction should be made between securities transaction taxes and capital duties.

202. **Countries Applying Securities Transaction Taxes**. According to the information provided, only 9 EU Member States (i.e. Belgium, Cyprus, Finland, France, Greece, Ireland, Poland, Romania and the UK) and 2 third countries (i.e. Singapore and Switzerland) apply securities transaction taxes. In addition, China applies a very specific kind of tax which can be compared to the "traditional" securities transaction taxes but cannot be considered as one as such ("business tax"). The characteristics of the tax very much differ in the countries applying it.

203. We refer to Enclosure 18 for an overview table in this regard and to Enclosure 22 for the detailed answers to the questions raised.

204. **Trade via Organised Markets**. The table in Enclosure 18 shows that only some of the countries apply securities transaction taxes when the transactions are carried out on an organised market (e.g. Belgium, Cyprus, Greece, Romania, Switzerland). In the other countries, the tax is not applicable to transactions carried out at a stock exchange (e.g. Singapore and France) or an exemption is allowed for securities listed at a recognised stock exchange (i.e. Poland) or traded on a qualifying market (i.e. Finland). In Romania, a commission can be applied if the transaction is performed on the regulated market/alternative trading systems or a monitoring fee if it is consummated outside the regulated market. Cyprus has two types of securities transaction taxes, the first only applying to transactions effected or announced at the Stock Exchange, the second (stamp duty) allowing an exemption for securities listed at a recognised stock exchange.

205. **Type of Securities**. The securities in scope of the tax can generally be divided into three groups. In most countries, the securities transaction tax mainly applies to equities (e.g. Finland). In some countries, the tax also applies to debt instruments such as bonds (e.g. Belgium, France) or loans with equity-like features, such as convertibles (e.g. the UK). Finally, in addition to equity and debt instruments, derivative instruments (equity swaps, call options, futures) are also sometimes within the ambit of the tax (e.g. Belgium, Greece, Ireland, the UK).

206. **Type of Transfer**. In most countries, the tax is applicable, as such, to the transfer of a security in scope (e.g. Cyprus, France, Greece, Poland). However, in a least one country (i.e. Belgium) the tax is due twice on a given secondary market transaction provided that the transaction is carried out between Belgian parties (in the hands of the seller (sale) and in the hands of the buyer (purchase)). Furthermore, in that country, redemption by an investment company of its own shares is also in scope.

207. **Taxable Basis**. The basis to which the tax rate is applied is not calculated in the same way in all countries. It is often linked to the type of security or transaction/contract in scope. Usually, it is either the sales price or other consideration (e.g. Finland, France, Greece), the purchase price/remuneration for the taxable security (e.g. Switzerland), the contract value (e.g. Cyprus), the market value of the securities (e.g. Poland) or the higher of the consideration paid for the transfer or the market value of the financial instrument (e.g. Ireland).

208. **Tax Rate**. All countries apply a proportional tax rate that is relatively low. However, the rate itself varies from country to country (e.g. 0.07%, 0.15%, 0.5%, 1.6%). In addition, some countries apply different proportional rates depending on the security in scope (e.g. Belgium, Ireland) or whether the transaction is performed on a regulated market (e.g. Romania). Switzerland applies a rate of 0.15% for domestic securities and a higher rate of 0.3% for foreign securities. Also, in some countries, the rate varies between certain thresholds (e.g. Cyprus) or is only applicable when a certain threshold is reached (e.g. France). Finally, in some countries the tax is capped at a certain amount (e.g. Belgium, Cyprus 'stamp duty'), while other countries do not apply a cap (e.g. Ireland, the UK, Switzerland).

209. **Territorial Scope**. The territorial scope of the tax may depend on several factors. It could be the nationality of the transferee and/or transferor in combination with the nationality of the security. For instance, in Finland, only certain Finnish securities may be subject to transfer tax if the transferee and/or the transferor is a Finnish resident or a Finnish branch of certain financial institutions. Another example is Irish stamp duty, which can apply if there is Irish property, if the transaction is executed in Ireland or if the transaction relates to anything done or to be done in Ireland, subject to exceptions. Also, in France, the tax applies to transactions performed either in France or abroad provided the transfer relates to shares/stocks of a French unlisted company or a company mainly holding real estate located in France. In the UK as well, the tax applies on shares issued by UK incorporated companies. In Switzerland and Belgium, the connecting factor is mainly the involvement of a local intermediary.

210. **Exempt Parties**. In Belgium, an exemption exists for non-residents and the Belgian financial services sector (e.g. banks, insurance companies, organisations for financing pensions, undertakings for collective investment) acting for their own account. In other words, only Belgian tax residents not belonging to the Belgian Financial Sector are in practice subject to the tax. Also, in the UK, certain recognised intermediaries (Financial Sector traders) are given an exemption for transactions in securities. In Switzerland, foreign banks and securities dealers should *inter alia* be considered as exempt parties.

211. **Liable Person**. The different types of persons liable to support the tax can generally be summarised under either the buyer / purchaser / transferee (e.g. Finland France, Ireland, Poland, Singapore) or the seller (e.g. Cyprus, Greece). The persons liable to pay the tax to the tax authorities will generally by the intermediary/securities dealer/local stock exchange (e.g. Belgium, Switzerland, Greece, Romania). However, in some case, the parties have to declare and pay the tax themselves (e.g. Finland, France, Ireland, Poland). This is often linked to the type of transaction in scope and the territorial scope of the tax.

212. **Secondary Market Transactions**. As far as the EU Member States are concerned, attention should be paid to Council Directive 2008/7/EC of 12 February 2008 or, previously, Council Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital. This directive provides for complete harmonisation of the cases in which the EU Member States may levy indirect taxes on the raising of capital. As a consequence of this directive, only secondary market transactions can be subject to securities transaction taxes, since taxes on primary market transactions are prohibited by article 5(2) of the directive. Further to the cases of “Commission v. Belgium” (C-415/02) and “HSBC Holdings plc v. Vidacos Nominees Ltd” (C-569/07) before the European Court of Justice, Belgium and the UK had to amend their legislation regarding securities transaction taxes in this respect.

213. **Abolition**. Finally, it appears that there is a trend toward abolishing securities transaction taxes rather than introducing them. For instance, the Italian securities transfer tax has been repealed for contracts signed on or after 31 December 2008. In Greece a bill has been tabled to abolish the

transaction duty on sales of listed shares initially acquired after 1 January 2012. Moreover, the Cypriot levy on transactions effected in respect of securities listed at the Cypriot Stock Exchange will cease to be of effect on 31 December 2011.

214. **Conclusion**. Only a limited number of EU Member States apply a securities transaction tax and in only part of these countries does the tax apply to transactions carried out on a regulated market. It is clear that this tax has not been harmonised on a European level. Whether or not the tax is applicable often depends on a combination of factors. The examples above also illustrate that the tax's features vary from country to country. We were able to identify three key questions that best allowed the types of tax to be sorted, namely (1) is the tax applicable to transactions carried out on an organised market? (2) which type of securities is in scope? and (3) what is the rate of the tax? Finally, we spotted two remarkable differences in treatment in Belgium and Switzerland. In Belgium the tax is not applicable to Belgian financial institutions acting for their own account, while other Belgian companies are subject to the tax. In Switzerland, a higher rate is applied to foreign securities than to Swiss securities.

3.2. Direct Taxation – Selected Derivatives

3.2.1. Introduction

215. **Classification of Derivatives.** The taxation of derivatives is a relatively complex matter for which there is no uniformity among the EU Member States. The complexity of this subject is mainly due to the complexity and diversity of derivative contracts themselves (and of their features), and generally not to the tax rules and principles applying to these instruments. The variety of different types of derivatives sometimes makes it difficult to classify the income and costs to which they give rise for income tax purposes.

216. **Derivatives in Scope of the Study.** For the purpose of the Study, three types of derivatives have been selected, namely equity swaps, financial futures and call options on stocks. These specific contracts can be defined as follows:

- A swap is an agreement between two parties – arranged with or without a financial intermediary – to exchange cash flows over a certain period of time. An equity swap is a swap where it is agreed to exchange a set of future cash flows between two counterparties at set dates in the future. The two cash flows are usually referred to as "legs" of the swap; one of these "legs" is usually pegged to a floating rate such as LIBOR. The other leg is based on the performance of either a share or a stock market index. This leg is commonly referred to as the "equity leg". Most equity swaps involve an interest leg v. an equity leg, although some exist with two equity legs.
- A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. A financial future is a futures contract on a short-term interest rate.

- A call option on stocks is a formal contract between an option seller (i.e. the option writer) and an option buyer (i.e. the option holder), which gives the option buyer the right, but not the obligation, to buy the asset specified in the contract (i.e. shares) by a certain date (the expiration date) for a certain price (the strike price).

Based on our experience, we note that the selected derivative contracts are not necessarily the types of derivatives representing the majority of derivative transactions performed by the Financial Sector. For example, in terms of figures, interest rate swaps and currency rate swaps are most probably more often used by financial institutions than equity swaps.

217. **Tax Provisions on Derivatives.** Most countries in scope do not have any tax provisions that specifically deal with derivatives in general and equity swaps, financial futures and call options on stocks in particular, and apply the general corporate income tax rules to these types of instruments (e.g. Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Ireland, Latvia, Luxembourg, Malta, the Netherlands, Romania, Slovenia, Spain, Sweden, Singapore, Switzerland). Some countries have embedded a few specific tax provisions or definitions in relation to derivatives or a specific type of derivative into their existing tax legislation (e.g. Greece, Italy, Lithuania, Poland, Portugal, Slovakia), such that these provisions are integrated into the body of other corporate income tax provisions. In addition, two countries, the UK and the USA, have developed a whole body of separate rules for derivatives which is very detailed and complex. Finally, as far as China is concerned, it can be noted that the Chinese tax authority has not yet issued any tax guidance with respect to swaps and that, at this stage, it is not permissible for non-resident enterprises to trade in futures or call options on stocks in China.

218. **Differences amongst Countries.** It is clear that the tax treatment of derivatives differs from country to country. Some countries even treat the same type of derivative differently depending on certain factors, for instance whether the derivative is listed or not (e.g. France, Greece) or whether the transactions are of a hedging or speculative nature (e.g. Belgium, Italy, Lithuania, Slovakia, Spain). This last distinction impels us to underline the decisive role of accounting treatment as, in the majority of the countries in scope, the tax treatment of a financial instrument is based on its accounting treatment, or is at least influenced by it.

3.2.2. Role of the Accounting Treatment

219. **Role of Accounting Treatment.** As mentioned above, in the majority of the countries, the starting point to determine the tax treatment of a financial instrument is its accounting treatment (e.g. Austria, Belgium, the Czech Republic, Finland, France, Ireland, Luxembourg, Spain), as tax law generally follows accounting law, unless there are derogations. Although the accounting treatment of financial instruments is not in the scope of the Study, it is impossible to assess the tax treatment of

financial instruments in these countries without considering the reporting framework and some basic accounting notions and principles.

3.2.2.1. Reporting Framework

220. **Tax v. Accounting Harmonisation.** Where the taxation rules applicable to financial instruments in the EU are not at all harmonised, the accounting rules in the different EU Member States have only to some extent already been subject to a certain degree of harmonisation.

221. **EU Directives on Annual and Consolidated Accounts.** The Fourth Council Directive (78/660/EEC) was a first step towards harmonisation of financial reporting in order to improve the comparability of accounting standards and financial statements. They state the overall basic accounting and reporting principles, which form the basis of local GAAPs (generally accepted accounting principles) implemented by each EU Member State. However, translation of the general principles set down in the Directive into national law and other sources of guidance by each EU Member State does still result in differences between the various national accounting frameworks. Other directives have been issued on consolidated accounts (83/349/EEC) and annual and consolidated accounts of banks and other financial institutions (86/635/EEC).

222. **Fair Value Directive.** In 2001, the "fair value" Directive (2001/65/EC) amended the three existing directives on annual accounts (78/660/EEC), consolidated accounts (83/349/EEC) and annual and consolidated accounts of banks and other financial institutions (86/635/EEC). It required EU Member States to permit or require the application of "fair values" for certain financial instruments, including derivatives, in respect of all companies or any classes of companies.

223. **IFRS.** Regulation (EC) 1606/2002 of 19 July 2002 introduced use of the IFRS framework into the EU's accounting and financial reporting legislation. As of 2005, publically traded companies had to report their consolidated accounts under IFRS. In addition, each EU Member State had the option to extend the application of IFRS.

224. **Diversity of Reporting Frameworks.** Today the coexistence of both reporting frameworks results in a rather varied international landscape of financial reporting, where companies either report under local GAAP or under IFRS or, as in many cases, under local GAAP for the statutory accounts and under IFRS for the consolidated accounts. In addition, the use of IFRS for preparing consolidated accounts may be an option or an obligation depending on the EU Member State and a number of other criteria (quoted company v. unquoted company, financial institutions, insurance companies, etc.). Finally, in many EU Member States, local GAAP lay down specific accounting frameworks for certain regulated companies such as credit institutions and insurance companies.

225. **Different Accounting Treatment.** The ultimate accounting treatment of a specific transaction by an individual company will depend on the accounting policies laid down by it. Since the accounting

frameworks do not always provide specific guidance or, in certain cases, even allow different options, a single transaction may be accounted differently by two similar companies operating in the same jurisdiction and applying the same accounting framework. Considering the different factors described above, when tax treatment follows the accounting treatment, an instrument can have different accounting treatment, and hence different tax treatment, throughout the European Union and even within a Member State.

3.2.2.2. Accounting for Financial Instruments

226. **Historical Cost v. Fair Value.** In the Fourth Council Directive (78/660/EEC) limited specific guidance was available with respect to the measurement of financial instruments and the main measurement or valuation principles referred to the use of purchase price or production cost (historical cost).

The "fair value directive" introduced the possibility for Member States to use fair value for the measurement of financial instruments, including derivatives. It also introduced the concept of hedge accounting.

This results today in a hybrid framework with differences between Member States, where historical cost (with adjustments to reflect decreases in value at balance sheet date) coexist with the use of fair value.

227. **Hedging v. Trading.** For derivative financial instruments, different accounting treatments are possible, depending on whether a derivative is contracted for hedging or for trading purposes. The different treatments will in most cases not only depend on intention but, in the case of hedging, will also depend on the effectiveness of the hedge relationship and its documentation.

The objective of hedge accounting is to avoid or reduce accounting volatility that does not reflect economic reality and is in practice achieved through different accounting mechanisms, depending on the Member State.

228. **One Instrument, Different Accounting Treatments.** The current accounting framework could result in different possible accounting treatments for a single type of financial instrument. These differences are not only driven by differences in the accounting frameworks of the different Member States (see Enclosure 23), but also by differences between statutory and consolidated accounts, differences in intention (hedging v. trading), differences between types of companies (e.g. commercial companies v. credit institutions) or even differences in the way a national framework has been transposed into the accounting policies of individual companies.

229. **Timing Differences.** These differences in accounting treatment will in most cases mainly give rise to timing differences, however. Generally, when a derivative is used for example, the valuation method used might have an impact on the company's financial position – and therefore also on its

taxation – throughout the term of the financial instrument, but at maturity, when the result is realised, the accounting impact will be the same, regardless of the measurement method applied throughout the life of the instrument.

3.2.2.3. Specific Accounting Rules for Financial Institutions: Potential Impact on the Tax Treatment of Financial Instruments

230. **Specific Accounting Rules for Financial Institutions.** More than half of the countries report that there are specific accounting rules for (some of) the financial institutions in their country.

231. **Irrespective of the (Non-)Listed Status.** This conclusion applies irrespective of the listed or non-listed status of the financial institutions.

232. **Potential Impact on the Tax Treatment.** In part of the above mentioned countries, these differences in accounting treatment could lead to differences in tax treatment (e.g. Austria, Belgium, Finland, Germany, Hungary, Italy, Luxembourg, Romania, Spain, Sweden, Switzerland). In most of these countries this can be explained by the fact that the corporate income tax is computed based on the accounting framework that is applied for financial institutions (e.g. Austria, Belgium, Latvia, Luxembourg, Spain, Sweden). In almost all of these countries the difference in tax treatment consists of timing differences.

233. **IFRS.** It should be noted that in the majority of the survey countries, banks and other financial institutions generally prepare their financial statements under IFRS or local rules inspired by IFRS. Only in part of these countries the accounting treatment of financial institutions might differ from the accounting treatment of "normal" companies. However, in most of the latter countries there is in principle no difference in tax treatment of financial instruments.

234. **Examples.** The above considerations can be illustrated by the following examples:

- In Germany there are some specific accounting rules in place for banks and financial institutions e.g. with regard to the valuation of financial instruments and with regard to accounting reserves for general risks of the banking business. However, the tax treatment might differ from the specific accounting rules e.g. the accounting reserves for general risks of the banking business are disregarded for taxation purposes. The specific accounting rules could lead to a different tax treatment of the financial instrument (differences in timing);
- Poland applies specific accounting rules for (some) financial institutions (e.g. specific accounting rules for provisions for bad debts in banks), but this does not lead to a different tax treatment of the instruments;
- In the Netherlands banks and other financial institutions mostly use IFRS, and in some instances Dutch GAAP. There are no specific accounting rules for banks and financial institutions included in

IFRS of GAAP, however there are certain accounting rules that have more impact on banks than other companies and thus banks primarily focus on these rules.

3.2.3. Mark-to-Market in Relation to Financial Futures and Call Stock Options

235. **Introduction.** One of the questions specifically asked in the questionnaires was whether mark-to-market is applicable in the survey countries in relation to financial futures and call options of stock. When mark-to-market is applied, the price or value of a security, portfolio or account is recorded in the accounting so as to reflect its current market value rather than its book value. For a general overview of the answers received to this question, reference is made to Enclosure 19, 20 and 21.

236. **Results.** The results can be summarised as follows:

- It appears that mark-to-market is not applied in most countries (e.g. Cyprus, Lithuania, Luxembourg, Switzerland).
- In some countries like Hungary, mark-to-market is optional, but is not usually applied. In the Netherlands, assets are generally valued at cost price or the lower market value, but valuation at mark-to-market is also allowed under Dutch tax accounting principles, for both financial and non-financial players. Note that taxpayers should of course use any valuation system consistently.
- Then there are also countries where mark-to-market is not in principle applicable to "normal" companies, while financial institutions in these countries might be permitted to apply or generally apply mark-to-market valuation (e.g. Finland, Austria, Romania). For example, in Sweden, financial companies apply mark-to-market but with an option to use cost instead of fair value, provided that cost is used for all securities in the company.
- In some countries, mark-to-market is generally applied by all companies, including financial institutions as well as normal companies (e.g. Bulgaria, Germany, Malta, Portugal, Slovakia, the Czech Republic for tax residents), though exceptions may apply (e.g. the USA). For example, provided that the underlying assets are not delivered under the swap or future contract, the contract will be taxed separately in Denmark according to the mark-to-market principle. Mark-to-market also applies in Greece to futures listed at the Athens Stock Exchange.

237. **Particularities.** In some countries the line is not easily drawn between the application of mark-to-market or otherwise. For example:

- In Ireland, mark-to-market is generally applied for financial companies, where it is used for accounting purposes. For non-financial companies, taxation generally only arises when there is a disposal. Where that is not at arm's length, mark-to-market is imposed for tax purposes.
- In Austria, mark-to-market valuation has to be used if the equity swap is held in the trading book or not held as fixed assets. If it is held as a fixed asset, the lower of cost or market valuation has to be used. For hedge accounting, rules similar to IAS 39 are applicable.

238. **Non-Financial Institutions Treated Differently.** Some of the survey countries report that the accounting rules for financial institutions differ from those applied by non-financial companies, which of course could indirectly cause differences in the timing of the taxation of a derivative instrument between financial and non-financial companies (e.g. Belgium, France, Luxembourg, Slovenia, Spain). However, this difference in tax treatment can primarily be explained by the difference in accounting treatment.

239. **Mark-to-Market Is Not More Beneficial.** In this context, we do not find any indications that the tax treatment of a financial instrument is more beneficial where the mark-to-market valuation method is applied. In some cases it will be more advantageous for a company to record a profit or loss at a given time in a given taxable period while in other cases the timing might be inconvenient.

240. **Mark-to-Market Less Beneficial.** The mark-to-market is sometimes even less beneficial from a tax perspective. For instance, as an increase in the market value of a financial instrument should be recorded in the profit and loss account earlier based on a mark-to-market valuation than on a lower of cost or market valuation (below *"LoCoM"*), the income will also be taxable earlier in countries whose tax rules follow the accounting rules. This example shows that mark-to-market valuation is not necessarily always more beneficial in comparison to historical cost or a LoCoM valuation.

3.2.4. Tax Treatment of Payments, Gains and Losses

241. **Common Tax Treatment.** As mentioned above, in the absence of any specific tax rules with respect to derivatives, the accounting treatment plays an important role in the majority of the countries in determining the tax treatment of the derivative instrument. Of course, there are countries in which accounting treatment is less important. Having compared the tax regimes applied by all the survey countries in relation to equity swaps, financial futures and call options of stock, it can be established that the majority more or less apply the same tax treatment to income derived from these instruments. This common tax treatment will be used to compare exceptions to the general rule or curiosities in certain countries. Note that some exceptions where there is a difference in treatment between financial companies and non-financial companies are discussed separately under section 3.2.7 below.

242. **Comparative Tables.** To be able to compare the tax regimes in the different countries, we have drawn up a table for each selected security, containing a general overview of the answers received on the basis of the questionnaires (see Enclosures 19, 20 and 21). Note that these tables are not of course exhaustive and do not include all the qualifications made in the completed questionnaires, which can nevertheless be consulted *ad longum* in the annexes. When comparing the results for equity swaps and financial futures, we noticed that the tax treatment of both financial instruments is very similar. Therefore, we discuss the tax regime of equity swaps and financial futures under the same section. Call options on stock are dealt with under a separate section, given the extra dimension caused by the payment of a premium and potential acquisition of the underlying stock.

3.2.4.1. Equity Swaps and Financial Futures

243. **Overview Tables.** The tax treatment of equity swaps and financial futures is schematically summarised in Enclosures 19 and 20. We refer to Enclosure 22 for the detailed answers to the questions raised.

244. **Common Tax Treatment.** A comparison of the tables contained in Enclosures 19 and 20 clearly shows that, in the majority of the survey countries, income from equity swaps and futures is taxable and complementary losses are tax-deductible (e.g. Austria, Belgium, Bulgaria, Denmark, France, Germany, Ireland, Switzerland).

245. **Timing.** The question is when exactly these gains are taxable or these losses are tax-deductible: on an unrealised basis (e.g. Denmark) or when actual realisation takes place (e.g. Bulgaria, Finland), on an accrual basis (e.g. Austria) or on a cash basis? By application of the prudence concept, in Latvia, unrealised gains (or losses) are non-taxable (or fiscally non-deductible), while realised gains (or losses) are taxable (or tax-deductible). As these timing differences are mainly caused by the applicable accounting treatment (see section 3.2.2 above), they are not taken into consideration in the tables.

246. **Exceptions.** There are, however, countries that do not follow this general tax treatment or for which there are some particularities of note. This can be illustrated with the following non-exhaustive examples:

- In Cyprus, income from equity swaps is not taxable, losses are not deductible. As far as futures are concerned, if the underlying assets are shares, bonds, debentures, founders' shares, other securities issued by companies/legal persons or rights thereto, then gains are exempt from income tax and losses are deductible. Otherwise, if the underlying assets are none of the above, for example futures on forex/commodities, gains will be taxable and losses tax-deductible. In other words, here the asymmetrical tax treatment of equity and debt seems to be preserved.
- In Estonia, payments received under swaps and futures are taxable, but only upon distribution. Furthermore, there is no calculation of tax losses, as only distributions are subject to corporate tax.
- In Greece, equity swaps and financial futures fall under the definition of derivatives for taxation purposes. A difference should be made between listed and unlisted derivatives. Listed derivatives are exempt from taxation, provided they are posted in a special reserve account, which can be used to offset future losses from listed derivatives. This reserve account is subject to tax upon distribution or liquidation. Unlisted derivatives, on the other hand, are subject to tax based on general provisions. Losses from unlisted derivatives are tax-deductible on condition that the transaction has been effected for hedging purposes, which means that the payments cannot be considered separately. In Greece, accounting treatment does not affect the above rules.
- In Slovakia, the general rule is that the overall loss from transactions with derivatives is not tax-deductible unless the taxpayer is a company in the Financial Sector or the transaction involves a

hedging instrument. On the other hand, cumulative gains from transactions with derivates are taxable.

3.2.4.2. Call options on stock

247. **Several Consecutive Transactions.** As previously mentioned, call options on stock can be distinguished from swaps and futures because they are acquired in exchange for a premium. A call option on stock gives the holder the right to buy certain shares for a certain price during a certain period of time. As a result, a number of different stages can be distinguished. In a first stage, the call option is issued/acquired in exchange for a premium in the hope of later acquiring shares at an advantageous price. In a second stage, the call option might be exercised to buy the shares. Finally, in a third stage, the shares itself can be sold. It is clear that the second and third stages will not always be reached. For instance, if the option is not exercised, it will expire. It is also possible to sell the option itself to another party.

For each transaction the question can be raised whether the gain or loss realised is taxable or tax-deductible. The answers received in the questionnaires are schematically summarised in Enclosure 21. Of course, for more details, reference is made to the questionnaires themselves in Enclosure 22.

248. **Legal v. Beneficial Ownership.** As a preliminary remark, it should be mentioned that options could pose difficulties for the concept of ownership. For example, in Luxembourg, for call options specific attention should be paid to determination of who the beneficial or economic owner is. Generally, the economic owner is deemed to be the legal owner. However, in certain specific circumstances, the economic owner could be different and should normally prevail for Luxembourg tax purposes. This may lead to the option being disregarded and the option buyer being directly considered as already holding the underlying assets.

3.2.4.2.1. Tax Treatment of the Premium

249. **Premium and Stock Acquisition/Delivery Price.** First of all, we focus on the tax treatment of the premium paid by the holder to the writer of the option. It appears that, in the majority of the countries, the premium paid is part of the stock acquisition price (e.g. Austria, Belgium, Bulgaria, Germany, Luxembourg, Slovenia). However, in some of the same countries, the premium does not seem to form part of the stock delivery price in the hands of the option writer (e.g. Denmark, Finland, Germany, Slovakia). In a minority of the countries, the premium is not part of either the stock acquisition price or the stock delivery price (e.g. Poland, Portugal).

250. **Holder's Deductibility Timing.** In almost all the countries, the premium is tax-deductible in the hands of the holder, but the timing of the deductibility is in most countries delayed until the time of exercise or expiry of the option. Again, reference can be made to the applicable accounting treatment, which naturally plays a role in the timing of the deductibility.

251. **Writer's Taxability Timing.** Complementary to the tax treatment in the hands of the holder, it can be said that the premium received by the writer is taxable in the hands of the writer in most countries. However, here, too, the question arises as to when exactly the premium is taxable. Again, timing often depends on when the premium is booked in the profit and loss account. In some of the countries, the premium is taxable upon exercise or expiry of the option (e.g. Austria, Bulgaria, Finland, France, Luxembourg, the Netherlands, Slovakia), whereas, in a few countries, the premium is already taxable upon the option being issued (e.g. Denmark, Germany).

3.2.4.2.2. Tax Treatment of Exercise and Disposal of the Option

252. **Exercise of the Option.** When the option is exercised to buy shares, the question is whether the gains or losses realised are taxable/tax-deductible. It appears that there is no uniform answer to this question. Half of the countries consider the gains taxable and the losses tax-deductible (e.g. Latvia, the Netherlands, Poland, Portugal, Romania), while the other half treat the gains as tax-exempted and the losses as not tax-deductible (e.g. Austria, Bulgaria, France, Hungary, Ireland, Italy, Lithuania, Luxembourg, Slovakia, Slovenia, Sweden, Switzerland, the USA).

253. **Disposal of the Option.** As mentioned above, situations occur where the option holder might decide itself to sell the option to a third party. In the majority of the countries, gains or losses realised on the sale of the option are taxable/tax-deductible.

3.2.4.2.3. Tax Treatment of the Sale of the Shares Obtained by Exercising the Option

254. **Sale of the Shares.** Gains or losses realised upon sale of the shares are also generally taxable/tax-deductible. However, in some countries, these gains may in very specific circumstances be tax-exempted based on local rules implementing a participation exemption regime (e.g. Austria, Belgium, Denmark, France, Hungary, Italy, Lithuania, Luxembourg, the Netherlands, Slovenia, Switzerland).

3.2.4.2.4. Particularities

255. **Exceptions.** Exceptions do of course exist to the common tax treatment of call options on stock. For example, in Cyprus, based on a ruling issued by the tax authorities on a specific transaction and the general interpretation in relation to securities, the premium paid by the holder is expected to be non-deductible, while the premium received by the writer is not taxable. The premium should be regarded as part of the stock acquisition price in the hands of the holder and as part of the stock delivery price in the hands of the writer. Gains realised by the holder upon disposal or exercise of the option are exempt. Gains realised upon sale of the shares acquired by exercising the option are generally exempt, except in certain circumstances. Furthermore, no gain can arise for a holder upon expiry of the option, as the premium already paid for its acquisition is expected to be treated as non-deductible. Gains upon exercise are not taxed in the hands of the writer.

256. **Packaged Product.** Options granted into a packaged product, such as an equity-linked note, are not taken into account on a stand-alone basis for accounting and tax purposes in some of the countries (e.g. Austria, Finland, Luxembourg, Sweden). The tax treatment will generally be that applying to the main product. In other countries, they should, however, be considered as two products (e.g. Lithuania, Poland, Romania). In some countries the answer to this question is not clear. Note that, in practice, questions with respect to packaged products should of course always be analysed on a case-by-case basis (e.g. Luxembourg).

3.2.5. WHT on Payments to Non-Residents

257. **No WHT on Payments to Non-Residents.** The question was asked whether there is any WHT (below, "*WHT*") on payments to non-residents originating from (i) equity swaps or financial futures, (ii) the sale of such instruments, and (iii) premiums paid to non-residents further to the acquisition of call options on stock. In the majority of the survey countries, there is generally no WHT on these payments to non-residents (e.g. Austria, Cyprus, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Sweden, the UK), unless an exception can be applied (e.g. the USA). When the source state does not levy any WHT on payments to non-residents, this is of course not directly relevant to determine the payment's classification under the applicable double tax treaty (below, "*DTT*"). We refer to the next section in this respect.

258. **WHT in Specific Cases.** In some countries, WHT can be due depending on certain circumstances (e.g. 10% in Bulgaria, 19% in Slovakia). For example, in Singapore, swap payments to non-residents may attract WHT if they are made in connection with an underlying loan or indebtedness of the payer. However, if futures are concerned, there will usually be no Singaporean WHT.

3.2.6. Double Tax Treaties

259. **Diverging Views.** It appears that the survey countries sometimes take diverging views as far as the DTT classification of the income generated from derivative instruments and from the sale of such instruments is concerned. Of course, each DTT is different and should be analysed on a case-by-case basis, but it appears that the classification can generally differ from country to country. Also, in some countries, there exists uncertainty in relation to the appropriate classification, and so the matter is open to interpretation (e.g. Finland). Finally, in some countries, several potential classifications could be correct, depending on the facts. We refer to the tables contained in Enclosures 19, 20 and 21 for more details. The potential classifications can be summarised as follows.

260. **Nature of the Underlying.** In some countries the classification may depend on the nature of the underlying (e.g. Austria, Ireland), while in other countries this is not the case (e.g. Slovakia, Switzerland, Portugal).

261. **Classifications.** Some countries classify payments from an equity swap or financial future as "other income" (e.g. Austria, Belgium, Slovakia). In other countries, the classification of payments from these instruments is in principle "dividend income" for income from equity swaps and "interest income" for income from futures. Moreover, there are also countries that consider these payments as falling under "business profits" (e.g. Bulgaria).

Most countries classify payments upon the sale of an equity swap or a financial future as "capital gains" (e.g. Austria, Belgium, Bulgaria, the Czech Republic, Estonia, Slovakia, Slovenia, Switzerland), but there are also countries that classify them under "business profits".

In addition, there is no consensus with respect to the classification of premium payments paid to acquire call stock options. The classification could be "other income", "business profits", or "capital gain". In some countries this classification is even considered to be irrelevant (due to the absence of taxation in the source country in any case; the qualification being then more relevant for the country of residence of the beneficiary).

In Germany permanent payments (if any) should qualify as "other income". Where a sale of the swap agreement or futures is concerned, a differentiation should be made between two situations. If the underlying value is physically delivered the payment qualifies as "capital gain". On the other hand, cash settlements qualify as "other income".

3.2.7. Difference if Counterparty is a Non-Financial Institution

262. **No Difference.** In most countries, there is no difference in tax treatment if one or both counterparties are companies in the non-Financial Sector as opposed to the Financial Sector. If there is a difference, it is usually linked to a difference in accounting treatment. Some examples are listed below.

In Bulgaria, there is a difference in tax treatment between financial and non-financial institutions. Financial institutions recognise gains or losses on financial instruments (e.g. equity swaps, financial futures and call stock options) when they occur, whereas non-financial institutions recognise the gains or losses only on disposal upon the instrument's maturity.

In the USA, there could possibly be differences. For example, there may be a difference if a futures contract is used as a hedging transaction as opposed to a speculative transaction. As far as call options are concerned, dealers in securities, as opposed to non-dealers, typically have to apply mark-to-market accounting to options, potentially accelerating basis recovery.

Financial institutions in France usually apply a tax treatment that differs from that for non-financial companies, applying a mark-to-market approach, which results in taxation or deduction of unrealised gains or losses at each financial year closing date.

In Germany, as far as equity swaps and financial futures are concerned, taxes are deducted by the counterparty (generally a credit institution) paying any profit under the swap or future agreement to the recipient. Corporations can credit the deducted tax against their corporate income tax liability. However, if the recipient is a credit or financial institution, taxes are not deducted from the income. Instead, such institutions declare the taxable income in their corporate tax returns.

Contrary to normal companies, Greek banks are obliged to submit a tax return to pay tax on the balance of a special reserve in relation to capital gains deriving from listed derivatives. Following payment of this tax, the remaining profits should be booked in a special account and can be distributed or capitalised free of tax.

In Ireland and the UK, there is a difference in tax treatment depending on the trading nature of the transaction. In the case of transactions other than trading transactions, these countries' capital gains rules might apply as opposed to the Irish general tax rules or the UK's derivative contract rules. For example, if a non-financial player is involved and the underlying subject-matter relates to equities, then it is possible that the UK derivative contract rules will be inapplicable, in which case the general capital gains rules apply. In Ireland non-financial players are disadvantaged by comparison with financial players: if the tax category is Irish capital gains tax, to which the non-Financial Sector is most likely to be liable, gains are taxed at 25% while, if the derivative relates to a trading transaction, which is normally the case for the Financial Sector, trading treatment should apply at 12.5%.

In Sweden, if both parties are companies in the Financial Sector, the general tax regime, based on accounting treatment, will apply. However, for a party that is not a financial company, the capital gains rules apply, which typically deviate from the accounting treatment in terms of timing (i.e. recognition of gains and losses). In addition, there are some differences in treatment with respect to call stock options: a financial company (holder) may deduct an anticipated (unrealised) loss on expiration of the call stock option and deduct it from any kind of income, whereas a non-financial company may only deduct realised losses, and only from capital gains on stocks and other equity-based securities. Also, for the financial company that wrote the option, the premium received is taxable when it is recognised in the profit and loss account while, for non-financial companies, the premium received is taxable either when the option expires (for "marketable" options with a term not exceeding 12 months) or immediately (for other options).

In Slovakia, the overall loss from transactions with derivatives is generally not tax-deductible. However, this is not the case if the taxpayer is a company in the Financial Sector.

3.2.8. Differentiation amongst Domestic Company, Subsidiary or Branch

263. **No Difference.** Apart for Singapore and the USA, which are third countries, there is in principle no difference in tax treatment with respect to the above topics according to whether the (financial)

institution is a domestic one or a subsidiary or a branch (considered as a permanent establishment for double tax treaty purposes, to which the operations under review could be attributed) of a non-domestic (financial) institution.

In Singapore, WHT may be deducted at source by other Singaporean-based payers for certain payments made to a branch (differentiation based on the tax residence of the beneficiary), unless it has obtained an appropriate administrative waiver from the tax authorities.

In the USA, there could be potential differences depending on whether the institution in question is a company or a branch. For example, in the USA, branches of foreign financial institutions are subject to complex rules regarding income inclusion and the availability of certain deductions.

3.2.9. Practices

264. **In line with Legal Provisions.** In most countries, there is generally no information as to whether actual practice differs from the relevant legal provisions.

265. **Inconsistencies.** Nevertheless, this does not mean that actual practice is always consistent in a given country (or between sectors). The different types of issues reported are closely linked to the level of sophistication of the relevant tax legislation (which is, in turn, linked to the existing local market with respect to the relevant financial instruments):

- It has been reported that, in some countries, the local market is not at present fully developed, so that there is no real actual practice to speak of (e.g. Slovenia);
- Other countries reported that tax rules regarding derivatives are not very detailed, nor is the official guidance from the tax authorities, so that it is necessary to refer to the general provisions and principles of tax law, which leads to uncertain/inconsistent practices (e.g. Cyprus, Latvia, Malta, Romania);
- In other cases, the law provides flexibility so that there could be more than one way to appropriately reflect a transaction in financial statements and, hence, for tax purposes (e.g. Switzerland);
- Other countries reported the need to refer to a pragmatic approach in complex situations (e.g. the UK) or to a substance-over-form principle (e.g. the USA);
- Other countries reported potential inconsistency between sectors of activity due to the lack of official guidelines or limited case law (e.g. France and Poland);
- Finally, the state of constant flux in the tax provisions applying to derivatives has also been reported (China).

It is therefore usually recommended that transactions should be analysed on a case-by-case basis.

4. Conclusion

266. **Two Parts.** This Chapter can be split into two parts: indirect taxation on the one hand (securities transaction tax), direct taxation on the other hand (selected derivatives).

267. **Securities Transaction Tax.** As far as the first part is concerned, it can be concluded that not all countries in scope apply securities transaction taxes, and those that do have this type of tax all apply different rules and rates. In other words, there is no uniformity with respect to the scope of the taxes, tax rates or taxable bases. In some countries, the securities in scope are more limited than in others, where, in addition to equities, derivatives and loan instruments are also targeted. Another crucial distinction that can be made is the public or private character of the transactions in scope.

268. **Selected Derivatives.** The second part of this Chapter addresses a more complex and technical matter, namely the tax treatment of equity swaps, financial futures and call options on stock. As explained above, few countries have developed any specific tax rules dealing with this kind of instrument and those that have not apply the general tax rules.

269. **Role of Accounting Treatment.** Since tax law is based on accounting law in the majority of the countries, it goes without saying that accounting treatment has a decisive impact on tax treatment. Differences in accounting treatment will indirectly result in differences in tax treatment.

These differences can be explained by the application of local GAAP versus IFRS, different valuation methods, such as mark-to-market versus the LoCoM or historical method, accrual accounting versus cash accounting, prudence principle versus matching principle, etc. The hedging or trading purpose of a financial instrument will in most cases also trigger a different accounting treatment. However, the differences that originate from a different accounting treatment in most cases come down to timing differences.

270. **Different Tax Systems.** The other main reason underlying differences in tax treatment between countries is the fact that some have a general corporate income tax regime that is “original” compared to other countries. Some countries also provide for capital gains taxation for which separate rules apply. However, this does not necessarily mean that financial institutions in these countries are treated differently from “normal” companies.

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GENERAL CONCLUSION

271. **Corporate Taxation.**

We found no evidence that banks have a significantly lower or higher corporate income tax burden than companies active in other sectors, to the exclusion of bank levies. As a general rule, the applicable standard corporate tax rate (including any municipal rates), computation of the tax base, deductible items or tax reliefs and so forth are generally the same for banks as for companies active in other sectors. There may be some differences specific to the bank business, but *prima facie* these differences do not appear significant.

272. **Value-Added Taxation.**

Some key third countries like Switzerland and Singapore have VAT exemptions in place similar as those foreseen in the VAT Directive 2006/112/EC which do not allow a VAT deduction. Other key third countries, like China, have other systems in place such as for example a Business tax or have no special tax on financial transactions excluding insurance premium tax which is for example the case in the US.

Only seven EU member States have implemented the "option to tax" system in the EU community allowing a VAT deduction of input VAT on financial services. However there is a wide divergence in scope and application between these Member States. A similar system as the "option to tax regime" of the Directive cannot be retrieved in the key third party countries covered by this Study.

A lot of EU Member States have or will introduce other taxes on financial transactions. Only a few of these taxes have clearly been introduced to compensate for the application of VAT exemptions in Member States, while for the other countries such a direct link with the existence of the VAT exemptions on financial transactions does not exist. The most common additional tax on financial services is the insurance premium tax but there is again a wide divergence in scope and application between the EU Member States.

273. **Labour Taxation.**

We found no evidence that, prior to the financial crisis, lawmakers in the 31 surveyed countries adopted any specific tax concessions or surcharges exclusively applicable to pay in the Financial Sector. While 7 surveyed countries reported having taken legal initiatives to apply tax surcharges to pay in the Financial Sector after the financial crisis, only 3, being Greece, Italy and Ireland, still apply these surcharges today.

In addition, assuming that the Financial Sector has more intensively resorted to equity incentives in its pay packages, we found no evidence that this practice would have led to an actual alleviation of tax

burdening pay in the Financial Sector. Indeed when tax concessions were applicable to equity incentives they were almost always conditional.

In conclusion, we found no evidence that pay in the Financial Sector would have benefitted from any specific explicit or implicit alleviation of tax in comparison with other sectors.

274. **Financial Instruments.**

It results from the Study that not all survey countries apply securities transaction taxes, and that there is no uniformity with respect to the scope of these taxes.

With respect to the tax treatment of equity swaps, financial futures and call options on stock, few countries have developed any specific tax rules dealing with this kind of instrument. In any case, since tax law is based on accounting law in the majority of the countries, the accounting treatment has often a decisive impact on tax treatment. Differences in accounting treatment will indirectly result in differences in tax treatment. Other than that, we have not found major differences in the tax treatment applicable to these instruments between Financial and Non-Financial Institutions.

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Contents

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