LUISS Guido Carli
LIBERA UNIVERSITÀ INTERNAZIONALE DEGLI STUDI SOCIALI

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Eucotax

FINANCIAL CRISIS AND SINGLE MARKET

Proceedings of the Eucotax Wintercourse Opening Conference held at Luiss Guido Carli, 7th April 2011

Edited by Livia Salvini and Giuseppe Melis

ROMA - DISCENDO AGITUR - 2012

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FOREWORD

The EUCOTAX (European Universities COoperating on TAXes) is an intensive programme based on the desire of the participating universities (Luiss Guido Carli, Uppsala University, Katholieke Universiteit Leuven, Universitat de Barcelona, Georgetown University, Universität Osnabrück, Universiteit van Tilburg, Université Paris 1 Panthéon – Sorbonne, Wirtschaftsuniversität Wien, Budapesti Corvinus Egyetem, Universitas Varsoviensis, Universitas Lodzensis) to set up a permanent structure in order to stimulate the instruction in and research on European aspects of tax law.

The main subject area of the programme is the European Harmonization of Tax Law. Within this framework a course was held in Tilburg (NL) in 1993 on 'The Relationship between Fiscal and Commercial Accounts'. The course was set up as a try-out by the universities of Hamburg, Paris and Tilburg. Following its success, the number of participating universities was then extended with the addition of Leuven and London in 1993/94. Luiss joined the programme for the 1995/96 edition upon the initiative of professor Franco Gallo. In the same year Barcelona has joined as well. Vienna joined the network during the 1997/1998-course. Georgetown joined the Eucotax-network in 2001 and Budapest in 2004. Uppsala has been participating since 2009. The network extended in 2010 with new members from Poland; Warsaw and Lodz. Ultimately, the participants' intention is to cover the entire European Union.

The 2011 edition was held at Luiss University from April 6 to April 15 and the main theme was *Global Finance and taxation: "Financial and Economic Crisis and the Role of Taxation"*.

This booklet collects the contributions to the opening conference of the Eucotax-Wintercourse held on April 7, 2011 whose subject was *"Financial Crisis and Single Market"*.

After an analysis of the general framework of the economic and financial context made by Paolo Savona, the opening conference focused on the interactions between tax policies and the crisis of 2008 from a national, european and international perspective.

We would like to thank all the Authors that contributed to this volume and Federico Rasi and Alessio Persiani for their work in organizing the conference.

We would also like to thank Alessandro Giannelli, Federica Pitrone and Fabio Massimo Silvetti for their active contribution for the editing of this volume.

Livia Salvini
Giuseppe Melis

Welcome Addresses

Massimo Egidi
Rector Magnificus Luiss Guido Carli

Good morning,
it is an honour for me to open this conference and as the Rector of Luiss Guido Carli University it is my pleasure to welcome you, professors and students, to the 2011 edition of EUCOTAX Wintercourse.

Firstly, let me thank professor Savona for being here and professors Essers and Kemmeren for such an important initiative as the Eucotax Wintercourse, which brings together students and researchers from the most important European University and from Washington. A special thank goes, therefore, to all the professors and students of the participating Universities for being here and for participating to this conference.

EUCOTAX Wintercourse is really an international intensive programme on tax law and I'm pleased to say that Luiss strongly supports this initiative, because it contributes to the internationalization of our students and University.

The added value of this initiative is represented by the cooperation among different universities located in different countries: all the groups involved in the discussion will try to come up with solutions for the various problems arisen by those differences.

Therefore, I encourage our best students to participate to the EUCOTAX Wintercourse, which will also offer them the opportunity to foster international relationships which can be of support for their participation to other international programmes like ERASMUS.

This year the major theme of Wintercourse is Global Finance and Taxation – "Financial and Economic Crisis and the Role of Taxation", and students will discuss on many important subtopics, such as taxation of investment income of individuals, taxation of financial institutions, exchange of information and tax procedures, tax arbitrage, deductibility of interest in corporate taxation, fiscal and commercial accounting rules.

To introduce students to the main subject of the Wintercourse, and to give them a sort of blueprint for their analysis, this opening conference – "Financial Crisis and Single Market" – will analyze the economic and financial crisis from an international tax perspective and it will also stress the importance of the interactions between tax policy and the economic and financial crisis.

In particular, the opening Lecture by professor Paolo Savona will be about financial regulations and exchange rate regimes – and I believe that it is very important for you to follow carefully this presentation because it's full of important issues that gives you some sort of background ideas and helps you to put it in the right place the policy aspect of this story.

Then, after a general overview, the conference will cover the "tax aspects" of the financial crisis, such as international tax avoidance and tax evasion, tax strategy in the European Union and in the national tax systems, exchange of information and administrative cooperation and trends in business taxation after the crisis. The speakers will discuss how reforms of the tax system could contribute to bringing public finances back to a sustainable path and how the tax coordination in the EU might help in reaping the full benefits of the Single Market.

Just to go to the end I want to say something about Luiss that is hosting you.

Our University was born in the '60s on behalf of the decision of two important persons, Guido Carli and Giovanni Agnelli, who decided to create this new University intended to educate people for the future of the State, of the Italian government, of the public system and so on.

And we have been able – I believe – to follow to some extent this fundamental initiative.

Luiss offers courses and degree in Economics, Law and Political Sciences for about 7000 students.

We are very selective and I will be happy if you will have any chance to meet some of our "A level" students, because I believe that it will be useful for both parties and we strongly support the process, the decisions and the initiatives like this one, because – as I said before – they are going to contribute to our internationalization. Thank you so much for coming.

Welcome Addresses

Antonio Nuzzo
Head of the Law Department – LUISS Guido Carli

Dear Madams and Sirs,
thank everybody for being here at Luiss Guido Carli.

I'm speaking as Vice-Dean of the Faculty of Law, on behalf of Prof. Pessi, who apologizes for not being here today.

The Faculty of Law is pleased to have the chance to host the opening conference of the EuCoTax Wintercourse. As already said, the EuCoTax program brings together students and researchers form various prestigious universities throughout Europe and one of Luiss Guido Carli's main goals, and of its Faculty of Law in particular, is certainly that of expanding the horizons of the legal research towards an international and comparative perspective.

In particular, tax law and international tax law are one of the most important factors, influencing the ability of enterprises and business activities to compete in an economic global scenario. The choice of the seat of the company, and namely of its registered office, in the European Union is mostly influenced by the competition among the member States in the field of tax law.

In my experience, as business lawyer as well as professor of law, I had concrete evidence of the importance of the legislation on taxation, sometimes over that on business organizations, in determining the choice of the State of incorporation and consequently of the applicable law. Even for the establishment of a fully state owned company as the Brennerbasistunnel SE (the company owned by the Italian

and the Austrian State for the construction and operation of the railway tunnel under the Brenner) an important set of questions and discussions was dedicated to the choice of the seat. At the very end the parties landed in the relevant state treaty to the solution of having a "mobile seat": for a certain number of years in Innsbruck, than in Bozen and again back to Innsbruck. And it is probably not necessary to say that this solution was mainly for fiscal reasons.

Furthermore, it is well known that many financial institution in the EU have chosen to register their office and to incorporate under certain national laws, not only because the relevant member States provide an efficient set of rules concerning the business activities, but also, and mainly perhaps, because of the taxation regime.

As Prof. Egidi mentioned, it is possible that tax regimes have not prevented or have contributed to some extent to the financial crisis of 2008-9. Also, sometimes more favourable tax regimes go together with softer financial regulations: maybe a thorough research on some recurrence of events may underline a connection between the two phenomena.

Moreover, flexible tax regimes may play a very significant role in helping the distressed business activities to recover after a financial crisis. This is certainly one of the most important issues at hand here in Italy, where high taxation level severely harms the ability of business activities to retain profits, either for distribution to shareholders, or for new investment.

Anyway, I don't want to take more time, so that we can all listen to the opening lecture of prof. Savona.

Good work!

Financial Regulations and Exchange Rate Regimes: a Conundrum

Paolo Savona
Guglielmo Marconi University, Rome

My lecture is centred on financial rules and exchange rates regimes, a problem that I consider a conundrum.

We are still disputing if the Great Crisis of 1929 originated from real or monetary factors, but for the last crisis there are no doubt that it originated from the mismanagements of finance and from some weaknesses in international agreements and wrong approaches.

According to my opinion the weakness and wrong approaches can be individuated in:

1. the dual use of dollars as domestic and international standard,
2. the exchange standard regime,
3. the refusal to extend the use of SRDs as an international standard,
4. the freedom to choose the exchange rate regime by participants to the world trade under the WTO governance,
5. the freedom to convert official reserves in other currencies on the market and to use them for investments (with SWF-Sovereignty Wealth Fund),
6. the freedom to operate in OTC derivative markets.

These are the six weaknesses of the international approach to finance and money.

What is the underlying economic philosophy of these weaknesses?

Firstly, the fixed exchange rate regime fell under the pressure of the Chicago School on the better capacity of flexible exchange rate to adjust disequilibria.

Secondly, the controls implemented by public authorities failed due to the attractiveness of the idea of perfect rational markets extended to the financial sector.

Thirdly, the belief of the authorities that was possible not to exercise the function of lender of last resort, a public good which should be produced by central banks and governments.

In 1971 the US money creation lost its external constraint refusing to convert dollars in gold. Later, savings surplus areas (such as China) chose the fixed exchange rate, accumulating official reserves in dollars, converting them on the market into other currencies, and investing them mainly through Sovereign Wealth Funds.

As a consequence, exchange rates increasingly went out of equilibrium, pushing up foreign imbalances, weakening the constraints on public budgets and indebtedness, reinforcing the benign neglect on the creation of dollars for international use, inducing a substitution of traditional assets with derivatives and increasing the world financial leverage.

These are the consequences of the decision of leaving the dollar floating on the idea – defended by the Chicago School – that the adjustment in the balance of payment was possible with a different regime of exchange rates. On this point it has to be considered the dispute over derivatives, which faces the common judgment on the importance of the so called financial innovation.

Derivatives permit a better management of risks, but at the same time they create new risks of opacity and contagion, especially if they are in a synthetic or hybrid form.

So until we had plain vanilla derivatives it was possible to manage risk better than in the past, but when more complex derivatives were introduced we lost the possibility to understand what the market was doing.

My research permit me to say that derivatives market, at least some part of it, have the nature of a speculative demand behaving like the Keynes L^2 motive – because they react to the interest rate variation like the Keynesian demand for money for speculative motive.

«Complex» derivatives can be evaluated only assuming the shape of the risk which can only be known when the risks occur.

All the evaluation of the derivatives are based on the formula of Black and Scholes, but the use of this formula for complex derivatives permits to asses risks only when they occur. So derivatives do not have a better predictive ability, as they create a vicious circle predicting their own influence on the market; the dimension of the derivatives market was so big that instead of forecasting the behaviour of the market they induced the market in forecasting the behaviour of the derivatives.

This is my objection to the supporter of a completely free (derivatives) market.

Another position in literature in favour of derivatives was that they attenuate the asymmetry of information.

My objection is that this is not true for ordinary investors, but only among the main operators.

Moreover, it was argued that derivatives reduce a bid-ask price or risk premium consistent with assumption of the formula used to evaluate them, but not with the underlined reality – as the crisis demonstrated.

It was also argued that they eliminate the Nobel Coase «market noises», but on my opinion this is true only if they are used in a way consistent with their «virtues» instead of their speculative «possibilities».

The result is more moral hazard, less efficacy of controls.

The FED is still discussing if it possible and if it is a good solution to regulate the derivatives market, because they are not in condition to understand what are the real effects of derivative instruments.

The conclusion is that derivatives create more market uncertainties.

What is the state of affairs in terms of a new international monetary regime?

For economists regime means a set of reference in condition to help the operators on the market to take decisions, whereas rules are intended to act upon operators' behaviour.

What is the official interpretation of the current regime?

According to the G20 communiqué of financial ministers and central bankers on February 2011, "*The international monetary system (IMS) has proven resilient, but vulnerabilities remain, which raise the need to improve it in order to ensure systemic stability, promote orderly adjustment, and avoid disruptive fluctuations in capital flows, disorderly movements in exchange rates – including advanced economies with reserve currencies being vigilant against excess volatility – and persistent misalignment of exchange rates*" .

This is the list of targets which ministers and central bankers of the G20 are trying to reach – I don't believe it is possible.

Firstly, I don't see any relation between fact and consequences and the official declarations – even it is clear that true problems are behind the statements, but they cannot emerge because of cultural (or ideological?) disagreements and because of a growing conflict among national interests.

Secondly, after the dramatic outcome of the idea of the perfect rational market, it appears to dominate the philosophy of "governance through rules", without removing the institutional weaknesses and wrong approaches.

It is a mistake to think that it is possible to do derivatives contracts or to move capitals around of the world resting on the idea that the rationality of market is superior to rationality of authorities.

Furthermore, when we talk in Europe of a single market we are talking of something it is impossible to reach for a lot of reasons: we are organized in national states with money sovereignty in the hand of an authority which is not behind political organization; fiscal policy is in the hand of each member states, and so on.

It is impossible to have a "pure" free market on which we can apply the so called philosophy of perfect rational market.

What is the current economic regime in the EU? What is the set of rules which permit to the European operators to behave?

The Maastricht Treaty is based on two pillars: money sovereignty and right to regulate the market at EU level.

To judge past, present and future regulations, we need to know the difference between ethics and morals.

Ethics concerns the objective or rational foundation of behaviour that enables us to distinguish right from wrong.

Morals concern the scale of values (or conventions) prevailing in any given moment, at individual or social level.

If regulations lack ethics and roots its choice solely on morals, it hardly facilitates the working of domestic and global markets.

Even if I am putting on the shoulder of the authorities the responsibility of the crisis, let me say that the ethics of the economic institutions lies in the commutative property of contracts, i.e. that both parties must benefit from each other.

In particular, the commutative property needs full transparency, governability of quantities and restriction on moral hazard.

Transparency does not only means that supply is to be clearly specified – which is the base of all the regulation of stock exchange – but also that the demand should be capable of understanding it clearly.

The governability of quantities of money and of financial assets means that their control is to be exercised by authorities not by the market.

One of the few point on which economists are in agreement is that money should be controlled, but the same conclusion was not reached for the financial assets.

Economists in the last half of the century have stated clearly that if you regulate in a different way the various components of money and financial market, operators will move to sectors where there are not controls or where they lack.

So my opinion is that we need one regulation equal for all the sections of the money and financial market.

If you control the bank credit through Basil III we need to apply the same for the derivative and financial market.

You cannot allow operators to move to different sectors of the market on the basis of a difference in their regulations rather than for rational considerations.

The control of moral hazard is a way through which it is possible to accept some basic principles of morals that are in condition to correct the rational foundation of ethics.

So you need in the regulation a certain in amount of morals but if you reverse and if the rules are founded on moral and not on ethics you are doing the wrong job and in the long run, as is doing in Europe, no international treaties can survive without having an amount of ethical rules: soon or later the system will drop.

Therefore, my first conclusion is the following: a good functioning of a global and domestic market cannot be obtained alone with better transparency, governance of quantities and less moral hazard but it needs an international monetary standard different from a national currency and the same exchanged rate regime to participate to the word trade under the WTO rules.

The second conclusion is that the utility of progressing step by step cannot be confirmed by economic history as in the case of Bretton Woods without the "bancor" and of Maastricht without a common fiscal policy, including tax treatment, and full freedom of capital and labour movements.

The second point is that introducing new rules for monetary and financial governance without solving the two problems of the international monetary system that have dogged us for centuries would doom those rules to failure.

My judgment is that what we are doing now will be, soon or later, expressed in the wrong way with respect to the utility function that the G20 expressed in its communiqué.

What is the end or the epilogue of my exposé?

The guide must be the search for a rational-ethical foundation, without detaching those decisions from their subjective or moral mooring as defined.

A rational-ethical foundations means to have an international money as a reference for global trade and to regulate the money and the financial market in the same way.

To avoid movement from one section of the market to another not induced by convenience, but by regulation, the latter should be neutral in terms of management of portfolio included tax regime.

My opinion is that the first task falls to economist – I mean to indicate the rational foundation of regulation – and the second to politicians in order to accept the amount of moral instance which will permit people to be directly responsible of their future.

The Tax Perspective: an Introduction

Livia Salvini
Luiss Guido Carli

Good afternoon and welcome.

Before I begin my speech, let me say that hosting this year's Wintercourse is a great pleasure for this University and for all of us who are involved in its organization. As hosts, we trust we have prepared well and the course will be a rewarding experience for all the participants.

So, I would like first to thank Professor Essers, the "driving force" behind the Eucotax Wintercourse. Since 1995, this program has been giving Luiss students – numbering almost one hundred by now! – not only the opportunity to study the European and International tax law, but also to meet many students from all over the world and to share ideas and knowledge.

Let me also thank all the professors of the participating universities for contributing to our discussions and, of course, the students, who are the active presence at every Wintercourse.

A special thanks goes to Professor Savona for being here today with us and for his opening lecture which gave us a very clear perspective on the economic and financial scenario of the crisis and possible solutions.

I would also like to thank Luiss and, in particular, Professors Egidi, Pessi and Nuzzo, for giving us the opportunity to take part in the Wintercourse every year and to organize and host this year's event here in Rome.

Moreover, let me thank Professor Gallo and Professor Severino, because it is through their farsighted initiative that Luiss, in 1995, joined the Wintercourse.

Finally, my thanks also to Professor Melis, Professor Ruggiero, Mr. Persiani and Mr. Rasi, who have been supervising the Wintercourse for several years and who undertook the coordination and the scientific and educational organization of this year's event.

Coming now to the theme of this Wintercourse, the financial and economic crisis which has hit the global economy must be analyzed also from a tax perspective, in an attempt to understand the interactions between tax policy and the crisis itself.

These interactions may be analyzed from a dual perspective. In fact, we can ascribe a dual role to tax policy: on the one hand, it can be seen as a *cause* and a factor which favored the crisis and indeed worsened it, and, on the other hand, as a *stimulus* to respond to and overcome the crisis.

As regards tax policy as a cause of the crisis we have to underline that even if the real causes of the crisis are still being strongly debated, a fundamental role has been attributed to national tax systems. In fact, different tax reliefs and incentives have been blamed for exacerbating the behavior of economic agents, leading to a high level of risk-taking and indebtedness of banks, families and companies[1].

Two examples can help us better understand this thesis.

First of all, we can reflect on the taxation of executive remuneration and in particular on the favorable tax treatment of stock options. In fact, the stock option mechanism has led managers to opt for short-term measures in order to increase the value of their stocks: as a result of this behavior, short-term risk-taking has obviously increased. The favorable tax treatment of stock options has in turn increased managerial earnings and a risky attitude.

[1] T. HEMMELGARN & G. NICORDEME, *Taxation Papers, The 2008 Financial Crisis and Taxation Policy*, Working Paper 20, European Union, 2010.

Secondly, in order to highlight a potential joint responsibility for the crisis, I would like to stress the role of international tax arbitrage, which is exclusively created by differences in the taxation of investors located in different countries and by the lack of transparency of these countries[2].

So far we have referred briefly to tax policy before the crisis and as a cause of the crisis.

Moving forward, we have to underline that fiscal stimulus packages have formed a part of the policy response to the crisis. In fact, the financial crisis compelled national States to intervene on a large scale. Such intervention was pursued not only through the recapitalization of financial institutions and the injection of liquidity into the market, but also through the implementation of many tax measures, with the aim, in the short term, of incentivating the market to overcome the crisis; and, in the long term, to stabilizing the market itself.

As a first reaction to the crisis, in November 2008, the European Commission presented the "European Economic Recovery Plan for Growth and Jobs"[3]. This Plan proposes the introduction of various tax measures to be adopted by Member States in order to support the real economy.

In accordance with the plan, Member States have since taken various measures, whose total fiscal value is estimated at about 1.8% of EU Gross Domestic Product[4]. According to studies on this matter, in the short term most of the measures taken by Member States have focused on decreases in labour tax and in corporate income tax[5].

[2] T. HEMMELGARN & G. NICORDEME, *Taxation Papers, The 2008 Financial Crisis and Taxation Policy*, cit.; T. ROSEMBUJ, *El arbitraje fiscal international. Los Hibridos Financieros*, in *Dir. e Prat. Trib. Internaz.*, 2, 2010.

[3] European Commission, *A European Economic Recovery Plan*, COM (2008)800, 2008.

[4] European Commission, *The EU Response to support the Real Economy During The Economic Crisis: An Overview of Member States Recovery Measures*, European Economy, Occasional Paper 51, July 2009, Brussels.

[5] European Commission, *Taxation trends in the European Union*, 2010.

In the long term, the plan intends to strengthen the competitiveness of Europe, thanks to the convergence of governmental actions towards "smart" investment, such as investing in clean technologies, energy efficiency, infrastructures and inter-connections to promote efficiency and innovation[6].

Moreover, we must also recall the importance of the report entitled "A new strategy for the single market" by Mario Monti. This Report underlines the importance of coordination of tax policy[7], and the fact that automatic exchange of information and cooperation between tax administrations of the Member States has to be improved[8]. Confirming this trend, in February 2011, the European Union implemented a new Directive on administrative cooperation in the field of taxation (2011/16/EU), which repeals Directive 77/799/EEC. This Directive follows the trend of the OECD and provides for the definitive elimination of bank secrecy.

Given the need for tax increases to reduce huge public debt, we are compelled to think of new taxes which could be levied at a European level. In particular, the opportunity to introduce a European financial transaction tax and a European carbon tax are under discussion[9].

Another point under discussion is the reform of the EU VAT system. In fact, the VAT system can play a key role in strengthening the Internal Market, most especially because, in the wake of the crisis, a shift towards indirect – rather than direct – taxation can be identified. For these reasons, the European Commission has published a green paper on the future of VAT to understand the

[6] European Commission, *A European Economic Recovery Plan*, COM (2008)800, 2008.

[7] On the concept of "tax coordination" in the European Union, see G. MELIS, *Coordinamento fiscale nell'Unione Europea*, in *Enciclopedia del Diritto, Annali*, I, Giuffré, Milano, 2007, 394.

[8] M. MONTI, *A new strategy for the single market*, Report to the President of the European Commission Josè Manuel Barroso, 2010.

[9] European Parliament resolution of March 8, 2011 on *Innovative financing at global and European level*, P7_TA(2011)0080, 2011.

problems that currently exist and how they can be resolved. This Paper proposes some potential changes to the current VAT system such as the harmonization of VAT rates and a compulsory list of lower VAT rates in the EU[10].

From the point of view of a European fiscal union, some scholars even support the handover by national governments of a substantial part of their national sovereignty, to take place at least in times of crisis by transferring national fiscal decision-making to a supranational authority[11].

I have tried to underline some tax aspects which have arisen both during and after the crisis and I have directed your attention to the fact that many tax solutions may be provided not only to overcome the current crisis but also to prevent future crises.

Other speakers will examine in greater depth the issues I have highlighted and will shed light on many others. In particular, Professor Rosembuj will analyze international tax evasion and tax avoidance issues, focusing on hybrid financial instruments. Professor Melis will speak about European and national tax strategy following the financial crisis. Professor Sacchetto will analyze exchange of information at European level and legal protection of taxpayers. Finally, Professor Essers will deal with new trends in business taxation after the crisis.

After this, there will be a debate during which all the professors of the participating universities will briefly share with us their countries view point.

I will then ask Professor Essers to draw some conclusions.

[10] European Commission, *Green Paper on the Future of VAT*, COM(2010)695, 2010.

[11] F. VANINSTENDAEL, *The Crisis: A Window of Necessity for EU Taxation*, Prof. Dr. Manfred Mössner Lecture, May 29, 2010, European Association of tax law Professors, Leuven.

Tax Avoidance and Tax Evasion in the Financial Crisis

Tulio Rosembuj
Universitat de Barcelona

Good afternoon, firstly, let me say that it is a pleasure to be here and that I thank the organization for inviting me to this conference.

The general title of my speech is "tax avoidance, tax evasion in the financial crisis". Curiously we have to begin with the concept, that in my opinion should have been clear but which was not, that most commentators thought that financial crisis has nothing to do with tax avoidance and tax evasion. Only a few believe in the contrary, i.e. that financial crisis, tax avoidance and tax evasion are inseparable and that you cannot understand the situation of the breakdown of the financial meltdown without knowing what happened with tax issues.

My first remark: financial activity considers the tax motivation as a way to generate financial accountants' earnings. Second: tax departments of corporations became profit making units, rather than tax management units – as it should be. Third: tax rules were converted into a source of financial earnings.

The invasion of financial activity in the tax field is complete. I am unable to think in a separate analysis of financial crisis and tax avoidance and tax evasion because tax avoidance and tax evasion were another future of any financial activity. That means that the meeting point of both activities was tax minimization for financial maximization of earnings and then this is the beginning of this speech.

The origins of the financial crisis are well known. In the nineties, the first experiences of Lehman Brothers, Long Time Capital

Investment and Enron were the school of financial malfeasance. Everything we know today about financial crisis was invented by Enron in the late 90's. The procedures, the mechanism, the elements are the same. The only difference is that we believed that the Enron experience was a specific experience and that was not true: the Enron experience has been disseminated, it has been spread all over the economic system and financial system.

Which were the elements of this school of financial malfeasance? First: the structure of financial transactions, which means the selloff of loan's exposure (mortgages, credit cards, bad titles, student's loan) to a special purpose vehicle (SPV) – which is an empty entity of balance sheet normally located in a tax haven. The bankruptcy remoteness of the SPV was the agent of the sponsor, the bank, the insurance company, the hedge fund, to build all kind of financial transaction's structure; the dominant form of this kind of transactions was the securitization, which means the issuance of over-the-counter derivatives with the blessing of the credit rating agencies.

In the first stage the underlying activity of derivatives was a real loan, it was an effective loan; at the end there was no real loan, no effective loan: it was invented on the paper as well as the concepts of collateral to the obligation and of credit default swap, which means betting at the same time in favour and against the investors.

The most valuable case in this field is the Abacus case from the fraud of Goldman Sachs, one of the last frauds discovered: Goldman Sachs betting against its investors in the praxis of securitization of mortgage loans that were in default.

Then, these were the elements of the Enron school, of the malfeasance financial school which grew to the present of the so called GSIFI, Global Systematically Significant Financial Institutions, no more than 20 (institutions) which control all the world finance. The GSIFI is a group of commercial banks, hedge funds and insurance companies. They avoided the regulatory arbitrage in their own country and shifted the risks in an opaque way to low taxation jurisdictions; they looked for short term cash flow and for long term

investment with unlimited leverage; then it came the breakdown. The false idea of self correction of the markets and the so called permissiveness of the States ignoring the red flags, the global risks and the interconnectedness between institutions, investors and States, brought the failure of the system.

At this point you can ask yourself what is the correlation to tax avoidance and tax evasion?

The answer is very simple: taxes were a co-operator of financial activity; without abusive tax planning, without tax shelter, without permanent differences in booked tax it would have been impossible for financial activity to obtain super profits, super earnings and super royalties during this era.

So we are obliged to consider tax issues as inseparable from the financial crisis, this is not only an opinion: the reaction we have seen after the G20 is the recognition that financial and money abuses have also to do with tax evasion, tax avoidance and money laundering.

Firstly, with the abusive tax design to skim, reduce, avoid, and evade taxes; secondly, through permanent difference in book taxes, which created the so called tax shelters: the creation of artificial losses through differences between book taxes. Thirdly, offshore industries which offer legal advice, banking and financial advice, opaque and secret advice, in offshore financial centres, tax havens and in other jurisdictions that are not necessarily tax havens. In addition, taxes are to be considered as a source for extirpating the legal risk of eliminating income taxes from certain kind of businesses, namely financial and multinational corporations. It was a kind of tax short-selling: the idea was to buy tax advantages and sell tax disadvantages. The application of the financial concept of arbitrage in the legal world. The system failure was due to a lack of understanding of the global risk, but the idea of market's failure we have to think about is that of (negative) externality – e.g. of social costs imposed on others: unemployment, bankruptcy *etc.* These externalities have to be internalized, in some way, by those that provoke the damages.

I'm optimist. I think the G20 forum is acting in the right way: regulation against irregularities, transparency against opacity, integrity against corruption. The G20 reacted against market abuses, financial abuses and also against tax evasion and money laundering and the traffic of capital.

The G20 carved the soft law, why? Because there was an important passage in terms of international principles at the time: first we have the so called transnational legal proxies, which means interaction, interpretation and internalization of international principles through local rules: for example the principle of abuse of law in Italy was inspired by the concept of abuse of law elaborated by the European Court of Justice.

The new stage is not a transnational legal proxies, it is the creation of common law international principles. This means that there are international common law principles that shape expectations of complying with binding rules, there are red lights warning for the route for every State: this is the novelty.

In all G20 speeches we heard the phrase: "international agreed standards", which means "international common law principle", which in turn means the application of international law principle to local law in a straightforward way.

This has been the best innovation promised by the G20 up to now. What does this mean?

Firstly, the principle of harmful tax competition has been assumed by the G20 with the special meaning of exchange of information (no bank secret, clear distinction between cooperative and non cooperative States). Under this principle tax avoidance, evasion, money laundering are linked in a way not so different from other crimes.

Secondly, the principle of antierosion of tax base – this is a radical change, since each State has the right to protect its tax base. An Italian economist, Vito Tanzi, talked about fiscal termites which serve to erode tax base. Now this principle is assumed by the G20. What does it mean? Regulation of transfer pricing, earnings, stripping, of abusive tax planning, of corporate tax base by debt

financing, of tax deferral not only on CFC but also in economic activity. All these changes are under the umbrella of antierosion of tax base principle.

Few years ago we had a notion about this complex antierosion tax base, I suggest a synonym which is not mine, Prof. E. Kleinbard wrote a beautiful essay called "Stateless Income". "Stateless Income" is an attribute generated by financial activity and multinational activity whose aim is to move the taxable base to low tax jurisdictions from high tax jurisdictions – e.g. to locate tax base in a way that does not bear taxes but captures tax rents. This means, in our economic systems, that there are agents which have the particularity of not being subject to taxation: through tax avoidance, tax evasion, they have the possibility to no taxation in any place of the world. So the content of "Stateless income" principle is the same as the antierosion principle. If there are agents which have income not subject to taxation, this means that we have States with taxes but with no significant taxpayers.

So, two principles and one new idea.

You know that taxation is omitted from the general agenda of globalization, why?

We talked about externality and one way to internalize them is by taxation itself; however, from the work of G20 and of EU Commission it seems that this omission is going to be removed.

In fact, they introduced a new expression, they invented the concept of "systemic levy". But, what does it mean "systemic levy"? Banks, multinational corporations, financial activities and derivatives assets should be taxed in a specific manner (e.g. the Tobin Tax): tax with names applicable to specific taxpayers.

This means, firstly, "one single tax for a single organization", because there is only one ability to pay.

Mario Pugliese, a well known Pavia Scholar proposed many years ago the creation of an international fiscal bank related to the international payments settlements of Basel; the creation of an international tax court; the apportionment formula or the common consolidated

tax base in the European language. This is the idea, it was utopic during the '20 e '30 but now it seems prophetic.

We need this answer for globalization, we need to invest in the structure of international tax law and in its enforcement.

That is the real challenge.

Financial Crisis and Tax Strategy[1]

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1. Introduction

The interaction between the economic and financial crisis that started in 2008 and national tax policies has a "double face": it concerns both the existence of specific elements of the tax systems that have *contributed* to the crisis and the role played by tax policies implemented by States *in countering* the crisis itself[2].

During the crisis governments have in fact introduced significant tax measures of a temporary or of a permanent nature, respectively to support the economy in the short term and to introduce structural reforms in their tax systems.

Three European documents are emblematic of the need to adopt also a "tax strategy" to overcome the crisis.

First, the *"European Economic Recovery Plan for Growths and Jobs"* proposed by the European Commission on November 26,

[1] Paragraphs 1, 2 and 4 have been written by Professor Giuseppe Melis and paragraph 3 has been written by Ms. Federica Pitrone.

[2] European Commission, *Monitoring tax revenues and tax reforms in EU member States 2010. Tax policy after the crisis*, Working Paper 24, 2010.

2008[3]. In this document the European Commission proposes a fiscal stimulus package to overcome the crisis. It aims at restoring consumer and business confidence, supporting demand and stimulating investment in the EU's economies, creating jobs and helping the unemployed return to work. The proposed fiscal stimulus plan involves Euro 200 billion shared by the European Commission (Euro 30 billion) and the Member States (Euro 170 billion).

In this context Member States have taken up several tax measures. Even if these measures differ widely across Member States, two common *trends* may be outlined. On the one hand, after the strong fiscal boost in 2009 which was meant to support the economy, fiscal stimulus packages were reduced due to the progressive deterioration of States' public finances[4]. On the other hand, the general decrease of direct tax revenues due to the introduction of fiscal measures aimed at supporting labour as well as the choice of many States to reduce corporate income taxes was balanced by a corresponding increase of indirect taxation, in particular through hikes in VAT and excise rates, in order to maintain the overall revenue level[5].

The second significant document is constituted by the Report *"A new strategy for the single market"*[6] prepared by Mario Monti, where tax perspective is considered as an essential element to build *consensus* on a stronger single market. In particular, tax

[3] European Commission, *A European Economic Recovery Plan*, COM (2008)800, 2008.

[4] According to the Commission services' spring 2010 economic forecast, the debt level is expected to increase from 58.8% in 2007 to 83.8% in 2011, European Commission, *Monitoring tax revenues and tax reforms in EU member States 2010. Tax policy after the crisis*, Working Paper 24, 2010.

[5] European Commission, *Monitoring tax revenues and tax reforms in EU member States 2010. Tax policy after the crisis*, Working Paper 24, 2010.

[6] M. MONTI, *A new strategy for the single market – At the service of Europe's economy and society*, Report to the President of the European Commission Josè Manuel Barroso, 2010.

reforms to be implemented have to look at "tax coordination" while respecting national sovereignty. For this reason, the report on the one hand points out the necessity to reduce the EU fragmented tax landscape which causes significant *compliance costs* and administrative burdens for citizens and companies; and, on the other hand, it emphasizes the importance to loosen the tension between market integration and tax sovereignty and to devise solutions that minimise harmful tax competition and the concentration of the tax burden on less mobile bases, i.e. labour. According to the report, the most important areas where tax coordination would prove particularly beneficial are: corporate taxation (through a common consolidated corporate tax base), VAT and environmental taxation.

Thirdly, the European Commission Communication *"Towards a Single Market Act for a highly competitive social market economy: 50 proposals for improving our work, business and exchanges with one another"*[7]. This document, consistently with Monti's Report, holds that the "re-launch" of the Single Market will help us to overcome the crisis and that, in order to reach this goal, it is necessary to create a business-friendly tax environment. In particular, the Commission will take steps to improve the coordination of tax policies by proposing a Directive introducing a common consolidated corporate tax base (CCCTB); implementing a new VAT strategy on the basis of the Green Paper published in 2010[8] and adopting a proposal to revise the Energy Tax Directive[9]. On March 16, 2011 the Commission already

[7] European Commission, *Towards a Single Market Act For a highly competitive social market economy 50 proposals for improving our work, business and exchanges with one another*, COM (2010)608, 2010.

[8] European Commission, *Green Paper on the Future of VAT*, COM(2010) 695, 2010.

[9] Council Directive 2003/96/EC of October 27, 2003 which, in the opinion of the European Commission, fails to fully reflect the EU's goals concerning the fight against climate change and more efficient energy use; see European Commission, *Towards a Single Market Act For a highly competitive social market economy 50*

proposed the Directive on a Common Consolidated Corporate Tax Base (CCCTB)[10].

All these documents show the clear will of the European Institutions to counter the crisis also through "tax strategies" implemented not only by Member States but also through "tax coordination" at the EU level. Even Mervyn King, the governor of the Bank of England, recognized the need for a fiscal union to make the Monetary Union work[11].

From a fiscal point of view a "double approach scenario" is thus at stake: the supranational one, aimed at re-launching the European Single Market, and the national one. An overlap between the two approaches cannot however be excluded: it has recently been the case of the bank levy adopted by Germany, Denmark, France and Hungary, whereas a similar levy is under discussion at the European level as well.

Slightly lagging behind other States, Italian Government started thinking about a long term financial package aimed at reaching a balanced budget in 2014. This package is expressed in decree law n. 98 of June 7, 2011 then converted, with some modifications, into law n. 111 of July 15, 2011 regarding urgent provisions on financial stabilization.

Because of the inconsistency of this measure, the Government created other urgent legislations which converge into decree law n. 138 of August 13, 2011 (named "Additional package"). In the original version, this additional package was based on increasing tax revenue

proposals for improving our work, business and exchanges with one another, COM (2010) 608, 2010. The European Commission published on April 13, 2011 a proposal to amend the Energy Taxation Directive, see European Commission, *Proposal for a Council Directive amending Directive 2003/96/CE restructuring the Community framework for the taxation of energy products and electricity*, COM (2011) 169/3, 2011.

[10] European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base,* COM (2011) 121/4.

[11] Bank of England, *Quarterly Inflation report*, 2010.

of about Euro 25 billion in 2012-2013; with later modifications such an increase reached the amount of Euro 36 billion.

As we will see, this kind of reforms seems to be almost partially into line with other countries' fiscal choices aimed at countering economic and financial crisis. For sure they represent a first signal of Italian awareness about the compulsory necessity of implementing a new fiscal strategy to overcome the crisis.

On the other hand, we can not ignore that Italian Government, rather than realizing a comprehensive structural fiscal package, has preferred to create specific rules which increase revenues by intensifying fiscal pressure. This ruling behavior is maybe useful in order to counter the difficult Italian economic situation in the short term, but it actually creates disfunctionalities and it is very far from pushing Italian economic growth.

2. National tax strategies: the most important trends

Starting with tax strategies adopted by the States during the crisis, a comparative analysis allows to outline some trends.

A first *trend* concerns the shift from direct to indirect taxation, through above all hikes in VAT and excise rates[12]. The main reason for this is the relative efficiency of consumption taxes, being

[12] The crisis has not only impacted on the level of tax revenue but also on its composition. In particular, the increase of VAT rates can be summarised as following: EE: 18 -> 20; EL: 19 -> 23; ES: 16 -> 18; IE: 20 -<21; LV: 18 -> 21; LT: 18 -> 21; HU: 20 -> 25; ES: 16 -> 18; FI: 22 -> 23; EL: 19 -> 23; UK: 17.5 -> 20; RO: 19 -> 24 (announced); see European Commission, *Taxation trends In the European Union*, 2010. The U.K. system gives us the possibility to point out the changeability of tax measures. This State in fact introduced a 2% temporary VAT reduction (from 17.5% to 15%) till December 31, 2009 to encourage spending by consumers and businesses in the short term. But since 2011 the ordinary rate was increased to 20%; see HM Revenue & Customs, Vat – *Change of the Standard Rate to 20 per cent: A Detailed Guide for VAT-Registered Business*, December 2010.

consumption a broader and more stable base than profits and income.

The first sketch of decree law n. 98 of 2011 aimed at the gradual shift from direct to indirect taxation. In order to achieve this goal, the most accredited option was a 1% increasing of VAT rate, both for 10% reduced VAT and 20% ordinary VAT[13]. After some hesitations, Italian Government decided to increase the ordinary VAT rate. In particular, ordinary VAT goes from a 20% to 21% rate, increasing of 1%, like in other EU States[14]. This variation is applied on operations which take place as from September 17, 2011, date of entry into force of the law of conversion of decree law n. 138/2011.

However, this increase will not be directed to financing Irpef (personal income tax) reduction, as in Government's intentions, but to sustain public debt in order to reach a budget balance. Initially, Italian Government was intended to finance Irpef decrease with delaying VAT increase until the implementation of a fiscal package aimed at reducing Irpef rates[15].

A second *trend* concerns the changes to personal income taxes, also through fiscal stimulus packages and tax reductions in favour

[13] D. Pesole, *Rincaro IVA rimandato al 2013-2014*, Il Sole 24 Ore, June 30, 2011.

[14] R. Rizzardi, *L'Italia resta in linea con l'Europa,* Il Sole 24 Ore, September 9, 2011.

[15] D. Pesole, *La correzione sale a 59 miliardi,* Il Sole 24 Ore, September 7, 2011; M. Mobili, M. Rogari, *La manovra riparte dall'aumento dell'IVA*, Il Sole 24 Ore, September 7, 2011; R. Rizzardi, *Ora occorre ridurre l'imponibile evaso*, Il Sole 24 Ore, September 8, 2011. At first, because of strong management and labour's protests, it was decided to increase only "optional" VAT rate, excluding an immediate intervention. In fact, in delegated legislation draft, "a gradual revision of actual VAT rates" was generically discussed, officially in order to evaluate inflation effects due to the increase of this rate. For what concerns management and labour's protests, an analysis by Confcommercio's Center of Studies asserts that an Irpef cut and VAT growth is not advisable because of its depressive effects on consumption and its recessive effects on GDP (Gross Domestic Product): see Ufficio Studi Confcommercio, *Nota sugli effetti della possibile manovra fiscale "da Irpef a IVA"*, available at *http://www.confcommercio.it/home/Centro-stu/index.htm.*

of families and enterprises, also with a view to foster labour supply[16]. This is strictly linked to the argument according to which the financing of the welfare state through taxes may have to rely less on labour and corporate income and more on capital income[17]. In any case, it would be necessary to analyze social contributions regimes, whose increase would neutralize the reduction of personal income tax rate.

Regarding personal income taxation some examples can be made: Germany reduced the lowest personal income tax rate from 15% to 14% and it increased the tax-free allowance[18]. In Spain the "*Plan para el estímulo de la economia y el empleo*" introduced tax reliefs in favour of families and companies for a total amount of EUR 16,5 billion. In particular, Spain increased tax credits, social security rebates and adjusted deadlines of payments for specific categories of workers. Moreover, a 100% tax rebate to the wealth tax was introduced, thus abolishing it in practice[19]. Following in Spain and Germany's footsteps, France weakened wealth tax and 300.000 taxpayers will no longer be required to pay the tax. In fact, wealth tax is now paid at a rate of 0.25% and 0.5%, instead of 0.6% and 1.8%, on assets worth more than EUR 1.3 million, instead of the former threshold of EUR 790.000. On the contrary, Italy is going against the grain and discussing the introduction of a wealth tax[20]! Almost at the moment, Italian

[16] Doc. Servizio del Bilancio del Senato – *Il piano europeo per fronteggiare la crisi economica. Le misure di politica fiscale adottate dai principali paesi dell'Unione*; T. Hemmelgarn & G. Nicordeme, *The 2008 Financial Crisis and Taxation Policy*, Working Paper 20, European Union, 2010.

[17] European Commission, *Green Paper on the Future of VAT*, COM(2010) 695, 2010; M. Monti, *A new strategy for the single market – At the service of Europe's economy and society*, Report to the President of the European Commission Josè Manuel Barroso, 2010.

[18] From € 7.664 to € 7.834 retroactively as from January 1, 2009 and to € 8.004 as from January 1, 2010; European Commission, *Taxation trends In the European Union*, 2010.

[19] European Commission, *Taxation trends In the European Union*, 2010.

[20] F. Forquet, *Un piano in cinque punti per la crescita,* Il Sole 24 Ore,

Government decided to increase taxation rate on financial returns from 12,50% to 20%, except for government bonds which still have a rate of 12,50%[21].

Actually, an increase of stamp duty on "stock dossiers" has been decided. In particular, it concerns periodic reports about stock deposit sent by financial intermediaries to their clients. This rate growth involves reports about stock deposits with par value or stock refund value greater than or equal to the value of 50.000 Euros[22] (actually from 34,20 Euros if par value is less than 50.000 Euros, to 680,00 Euros if par value is greater than 500.000 Euros; starting from 2013, the maximum growth will reach an amount of 1.100 Euros). This increase has more or less the same effect of a wealth tax that Italy already has on property assets (ICI – Municipal Property Tax).

This increase on both stock deposit stamp duty taxation and rates on financial returns, together with the wealth tax already existing for real estate –with the exception of the house of the habitual abode of the taxpayer is located, originally taxed and whose exemption introduced in 2008 has been strongly criticized for its negative effects on municipalities' financing – and the high rates in personal income taxes, should in my opinion make the implementation of a general wealth tax a useless debate, but unfortunately the idea to introduce such a tax in Italy is showing a growing consensus.

Coming back to general issues, the measures we described were accompanied by the increase of tax rates for higher income

September 7, 2011, where these Assonime's ideas are mentioned: the introduction of a Contribution for Transparency and Growth (CTC – Contributo per la trasparenza e la crescita) and a 1% levy on assets to reduce companies taxation.

[21] D. Pesole, *Nella delega il concordato preventivo*, Il Sole 24 Ore, July 1, 2011; M. Cellino, *BoT e Fondi alla prova della riforma*, in Sole 24 Ore, July 3, 2011.

[22] M. Cellino, *Il bollo sul dossier titoli aumenta fino a 380 euro*, Il Sole 24 Ore, July 5, 2011; L. Serafini, *Deposito titoli, bollo graduale,* Il Sole 24 Ore, July 13, 2011; M. Piazza, *Rebus maxibollo sui rendiconti del deposito titoli*, Il Sole 24 Ore, August 11, 2011; *cfr.* Circular of August 4, 2011 n. 40.

earners. For example, Greece introduced an extra tax on personal income for income above EUR 60.000[23]. In Greece the real estate taxation regime also changed: the 1% flat rate on large properties was substituted by a progressive scale increasing the 1% top rate applicable above EUR 800.000 to 2% for property values above EUR 5 million for a period of three years (this rate is applicable also on Church property not used for religious, educational or charitable purposes). Ireland also introduced an extra tax on personal income for income above EUR 100.000 and is now planning to introduce a EUR 200.000 tax for people domiciled in the Country who have properties with a value above EUR 5 million, an income above EUR 1 million and pay taxes in Ireland for less than EUR 200.000.

Italy is actually implementing the so called "solidarity contribution" for taxpayers whose total IRPEF income is more than 300.000 euros/per year. This contribution, which at the moment applies to income earned in 2011, 2012 and 2013, has a rate of 3% and is applied on the income exceeding 300.000 Euros. It will involve more or less 34.000 taxpayers[24].

Always with reference to Italy, the measures that were implemented primarily concern the reduction of government spending: among them, however, there are some which are substantially equivalent to a tax rate increase, even if apparently they cannot be considered as fiscal measures – i.e. the public sector pay cuts. In Italy, moreover, the most sensitive problem concerns tax deductions which amount to EUR 140 billion. On this issue a specific ministerial committee is evaluating which tax deductions have to be maintained, thus giving to the government the opportunity to modify

[23] The tax is gradually increased from EUR 1.000 for income between EUR 60.001 and EUR 80.000 to EUR 25.000 for income above EUR 900.000; see European Commission, *Taxation trends In the European Union*, 2010.

[24] N. Cottone, *Contributo di solidarietà del 3% per i redditi oltre 300mila euro*, Il Sole 24 Ore, September 6, 2011; G. Trovati, *Contributo per 34.000 "paperoni"*, Il Sole 24 Ore, September 7, 2011.

and reduce tax rates. An intervention of rationalization of such tax deductions in order to finance personal income tax reprogramming has been under examination from several months. In the delegated legislation on fiscal package this reprogramming is structured using only three rates, respectively of 20%, 30% and 40%[25]. The additional package, as approved by the Senate, decided to immediately reduce fiscal tax deductions of about 4 billion in 2012 and 12 billion in 2013. This will happen unless fiscal and welfare regulations aimed at eliminating or reducing exemption regimes until a total amount of 4 billion in 2013 and 20 billion in 2014 would not be introduced[26].

With regard to the reduction of the tax burden on labour, this issue is strictly connected with fostering labour supply and labour demand incentives, which is one of the fundamental answers to the higher labour cost in the EU in comparison to other *competitors*. On this issue, in the future, tax incentives for the variable component of salaries may be introduced[27]. This could be done by modifying the meaning of labour remuneration, considering the variable part as the workers' participation into the company, providing incentive pay, shareholding, profit sharing and welfare services within the company. In Italy a 10% substitute tax is applicable now to the variable components of the remuneration, within the limit of EUR 6.000 and within the maximum income threshold of EUR 40.000, subject to territorial framework agreements. It would be desirable to eliminate any kind of threshold, specifying which part of the variable remuneration

[25] D. PESOLE, *Nella delega il concordato preventivo*, cit. This package, to be introduced in a short time, is aimed at modifying Italian taxation by reducing taxes to five kind of them: Irpef, Ires, Iva (VAT), Irap and tax on utilities, which is going to include registry duties, mortgage and land tax, tax on government concessions, tax on stock exchange contracts, tax on insurance and tax on leisure.

[26] D. PESOLE, *Dalle entrate il 65% della manovra,* see above.

[27] Fondazione REI – CERADI Luiss Guido Carli, *Riforma fiscale e redditi di lavoro dipendente: per una fiscalità volta verso il nuovo millennio*, December 2010.

should benefit from the tax relief, maybe as a percentage of the whole remuneration.

Finally, as far as the reduction of corporate income tax rates is concerned, we can see common trend on this issue too[28]. Anyway, it should also be analyzed whether this reduction was accompanied by the broadening of tax bases which obviously would neutralize it, as happened in Italy in 2007.

At first, it seems necessary to underline the new European Commission approach about State aid. In fact, because of the economic and financial crisis the Commission adopted some temporary measures in order to allow Member States to introduce tax incentives more freely in order to support banks and companies and to facilitate access to financing.

At the State level, Spain reduced the tax rate to 30% and to 20% for small and medium companies with less than 25 employees maintaining or increasing the labor force. In France, instead, a reduction of the *taxe professionnelle* for new investments was introduced[29]. On March 23, 2011, the UK Chancellor of the Exchequer George Osborne released his second budget law. The key change is a reduction to the main rate of the corporate income tax to 26%, effective from April 2011. This rate will then be further reduced by 1% per year over the following three years to a rate of 23% from April 2014. Moreover, the U.K. government is changing the CFC rules to make the UK more competitive. In particular, they intend to introduce a special regime for financial companies, providing a rate of one quarter of the main rate of corporation tax on profits of overseas companies. This is an important issue because it seems that the U.K. would like to be more competitive even with more tolerance towards companies located in tax havens. Lastly, according

[28] In particular, tax measures in order to reduce corporate income tax have been introduced in these States: AT, BE, CY, CZ, DE, ES, LU, NL, PL, PT, RO, SK, UK; see European Commission, *Taxation trends In the European Union*, 2010.

[29] European Commission, *Taxation trends In the European Union*, 2010.

to the latest news, in the USA there is a discussion about the reduction to 25% of the higher rate for corporate income taxation and personal income taxation. The aim of this amendment is to reduce the complexity of the current American tax system.

With reference to Italy, the level of the rate of corporate taxation still remains very high also considering the burden of Irap whose rate was increased in many Italian Regions and whose taxable base is very broad compared to that of corporate tax. This leads to an effective rate on business income which is by far higher than the mere sum of nominal rates of Ires (27.5%) and Irap (3.9%). However, that is not enough. In fact, "effective" tax burden on companies cannot be estimated only by adding Ires (27.5%) and Irap (3.9%) rate; we have also to consider the pressure to pay, which leads to a comprehensive tax burden on companies to 48.8%[30]. Real tax burden on companies has actually become untenable and, for this reason, in the bill of delegated legislation the Government seems to gradually promote Irap abolition starting from 2014, "taking priority over the exclusion of taxable amount due to labour cost"[31]. This eventuality makes operators and social partners doubting because it seems to have only postponed and not solved Italian situation yet[32].

At the moment, Italian Government has only dealt with the modification of tax system for the small entrepreneurs and self-employed workers who start a business in 2012 or have already

[30] See the study of CNA Abruzzo presented by C. CARPENTIERI, *Abruzzo e le tasse: un freno allo sviluppo ed imprese*, available at *http://www.cna.it/DIPARTIMENTI-E-UFFICI/Politiche-fiscali/News/Eventi-Forum-L-Abruzzo-e-le-tasse-un-freno-allo-sviluppo-delle-imprese*; M. BELLINAZZO, *In Abruzzo L'Irap più pesante*, in Il Sole 24 Ore, June 17, 2011.

[31] D. PESOLE, *Nella delega il concordato preventivo*, cit.

[32] E. DE MITA, *Una riforma " a futura memoria"*, Il Sole 24 Ore, July 1, 2011; A. SACRESTANO, *Abolizione Irap, missione fallita da oltre un decennio*, Il Sole 24 Ore, July 2, 2011; L. CORDERO DI MONTEZEMOLO, *"La manovra è un assegno post-datato"*, Il Sole 24 Ore, July 3, 2011.

started since January 1, 2008. These individuals will be liable to a 5% flat-rate taxation which will be applicable to the tax year in which the business has been started and for the following four years. On the other hand, for what concerns young people, this period of flat-rate taxation can be longer but cannot be applicable after they have reached the age of 35. This preferential tax system requires more strict access criteria than the previous one. The people who would not be subjected to it will be liable to a "residual" simplified tax system providing for exclusion from Irap and some other facilities with the exception of a decreasing Irpef rate. In a word, this preferential tax system actually involves a small number of taxpayers[33].

Another measure to support companies was the introduction of new rules on losses incurred in the years of the crisis. In particular, several countries increased both the losses carry-forward period and the losses carry-back period. In the Netherlands, for example, corporate taxpayers were allowed to carry back losses for two years with respect to the fiscal years 2009 and 2010[34]. Italy was again an exception: the carry-back of losses is not allowed and losses could be carried forward only for five years, which is the shortest period within the EU. Actually, the situation has been changing since Italian Government eliminated the 5-years limit. This actually positive removal is however accompanied by a limitation to the deduction of losses. In fact, each fiscal year, losses can be covered for an amount which is not greater than the 80% of declared income. This limit will not involve the losses originated in the first three fiscal years. The introduction of this deduction limit is actually due to cash requirements[35]. However, according to first commentators, the remaining

[33] L. DE STEFANI, M. MEAZZA, *Rivoluzione per i contribuenti minimi: tasse al 5% ma solo per pochi. Per gli altri arrivano gli studi di settore*, Il Sole 24 Ore, July 23, 2011.

[34] European Commission, *Monitoring tax revenues and tax reforms in EU member States 2010. Tax policy after the crisis*, Working Paper 24, 2010.

[35] L. GAIANI, *Perdite a deduzione ridotta*, Il Sole 24 Ore, July 1, 2011; F. CAVALLI,

20% will not be lost but will be though used to reduce companies' taxable income which is get during following fiscal years[36].

In order to support Italian companies, only a tax relief was introduced in 2009 for corporate recapitalization effected by individual shareholders[37]. In particular, the tax relief was a deduction equal to 3% of the capital increase for 5 years and for a maximum threshold of EUR 500.000. This measure, however, was temporary and it was not confirmed by Italian legislator: now companies increasing their capital do not have any kind of tax relief and they do not have the possibility to reduce taxable income through passive interests as well because, starting from 2008, the deduction of passive interest is exclusively connected to the "gross operating income" (quite similar to EBITDA).

At the present time, instead of reducing its own corporate income tax rate, the Italian government would like to introduce an original solution in order to boost foreign companies investments, importing in Italy the most favorable tax systems within the European Union. This is the so-called "Regime of European attraction", according to which individuals or companies established in another UE member State carrying out new economic activities in Italy can choose whatever tax system within the European Union to define their taxable income for three years[38].

Per le perdite riporto senza limiti temporali, Il Sole 24 Ore, July 2, 2011, according to the author, who agrees on the elimination of a time fence for losses carry-forward, "the choice of no more permitting the total absorption of fiscal losses from annual taxable amount determines companies financial penalization but it is actually aimed at preserving tax revenues which maybe, in actual economic context, could not be sacrificed".

[36] G. ODETTO, *Perdite fiscali riportabili all'80% senza limiti di tempo*, in Eutekene.info, July 4, 2011; G. FERRANTI, *La disciplina del riporto delle perdite si adegua alla crisi economica*, Corr. Trib., n. 31, 2011.

[37] Art. 6, c. 3-*ter* Decree Law n. 78 of July 1, 2009.

[38] Art. 41 Decree Law n. 78 of May 31, 2010 and Draft of Ministerial Decree on art. 41 Decree Law 78/2010 which is open to comments and criticisms. The regime has not been implemented yet, but according to some scholars, even if the regime seems to be a laudable initiative, the possibility to choose whatever tax system within

Another measure was the increase in taxation on bonuses and stock option plans, based on the decisions taken during the G20 in order to avoid distortions on the financial market and on global economy. In particular, Italy introduced a 10% additional tax on bonuses and stock options exceeding the triple of the fixed salary paid to managers of financial institutions[39]. Even France introduced a 50% tax on bonuses exceeding EUR 27.500 paid by financial institutions to their traders. In the United Kingdom an additional 50% bank payroll tax on the excess bonuses over GBP 25.000 granted by banks and building societies was introduced[40]. In Greece bonuses to executives in banks and financial institutions are now subject to a special taxation regime with progressive rates ranging between 20% and 90%[41].

The implementation of these measures was founded upon the idea according to which the overcoming of the crisis is to be financed by the sector which caused it. Accordingly, a higher taxation of financial institutions was introduced as well. Germany approved a draft bill introducing a new tax on banking with the aim to create a "financial equalization fund". The payment of this tax is connected to the liabilities of banks and to off balance sheet derivatives. In particular, banks with liabilities up to EUR 10 billion will pay a 0.02% tax, increasing to 0.03% for liabilities between EUR 10 and 100 billion and to 0.04% for liabilities over EUR 100 billion. Hungary[42], Denmark and France[43]

the European Union could be considered as State aid and harmful tax competition.

[39] Art. 33 Decree Law n. 78 of May 31, 2010. On the basis of a challengeable interpretation adopted by the Italian tax administration, such an additional tax has been extended to all the executives of holding companies.

[40] T. HEMMELGARN & G. NICORDEME, *The 2008 Financial Crisis and Taxation Policy*, Working Paper 20, European Union, 2010.

[41] European Commission, *Taxation trends In the European Union*, 2010.

[42] In particular, financial institutions are liable to pay this tax on their annual balance sheet at a rate of 0.15% up to HUF 50 billion and at a rate of 0.53% above this threshold. Financial institutions are also obliged to pay a special tax on their profit at a 30% rate. The special tax on the financial sector will be effective till 1 January 2013: see D. DEÁK, *Global financial crisis and Hungarian crisis taxes*, in this volume.

[43] In France the bank levy will be paid at a rate of 0,25% of the minimal

introduced a special tax on financial institutions as well. Also in Italy, bank taxation represents a hot spot and a lot of different taxation systems have been taken into consideration. In fact, regarding the content of the package, it was at first discussed about a 35% taxation on bank trading activities, then about a 7% additional taxation on financial trading and at last about a 0,15% taxation on financial transactions. None of these proposals has become a reality, while a Irap rate increase at 4,65% for banks plus other financial companies and at 5,90% for insurance corporations[44] has been actually implemented.

Another measure consists in the introduction of alternative sources of tax financing. Greece, for example, introduced a special levy on luxury goods (aircraft and boats) and planned the introduction of a "green tax" on CO2 emissions. A great number of measures were taken in the area of environmental taxation as alternative sources of financing. Germany planned the introduction of a tax on nuclear power and on flight. Denmark provided higher energy, transport and environmental taxes[45]. This same path was also followed by Ireland, Greece and the Netherlands[46].

capital required under French regulatory rules, as computed on risk-weighted assets. French branches of European banks are exempted. See D. GUTMANN, *Taxation after the Crisis. A French Approach*, in this volume.

[44] L. SERAFINI, *Per le banche italiane una tassa da 250 milioni*, Il Sole 24 Ore, July 3, 2011; M. CELLINO, *Fisco e credito: salta la stretta sul trading e Borsa*, in Sole 24 Ore, July 2, 2011; L. SERAFINI, *Credito e finanza, scampato pericolo*, Il Sole 24 Ore, July 1, 2011; M. MOBILI, *Trading bancario tassato al 35%*, Il Sole 24 Ore, June 30, 2011; L. SERAFINI, *Crisi e fisco: Piazza Affari rischia grosso*, Il Sole 24 Ore, June 30, 2011; L. SERAFINI, *"Con questa tassa fuga all'estero degli investitori"*, Il Sole 24 Ore, June 30, 2011; M. PIAZZA, A. SCAGLIARINI, *L'aumento Irap colpisce le holding*, Il Sole 24 Ore, July 20, 2011.

[45] In particular, in 2009 Denmark initiated a major tax reform to be phased in from 2009 to 2019. The reform aims at reducing the high marginal tax rates on personal income (the lowest marginal rate from 42.4% to 41% and the highest marginal rate from 63% to 56.1%) and thus to stimulate labour supply (the effect is estimated at 19.200 full time employed). The reform is financed by higher energy, transports and environmental taxes, and also by increases of excise rates on health-related goods (fat, candies, sugar, tobacco). See European Commission, *Taxation trends In the European Union*, 2010.

[46] European Commission, *Monitoring tax revenues and tax reforms in EU*

In Italy, a tax on luxury goods has been preferred: the Government has in fact introduced an annual additional rate on vehicle tax for cars with more than 225 Kw power[47]. Moreover, the Government has decided an increase from 6,5% to 10,5% of the so called *Robin Hood tax*, an Ires additional rate for companies working in oil and electricity industry. This increase will be applied during the three fiscal years following the one ending on December 31, 2010. On the one hand, the Legislator has widened the range of subjected companies, including the ones operating in the renewable energy industry; on the other hand, the typologies of included renewable energies was widened, adding the activities of transmission and dispatching of electricity, gas transportation and gas plus electricity transportation[48].

The last *trend* I want to point out is the strengthening of the instruments of tax assessment and broadly speaking of measures to fight tax evasion and tax avoidance.

The Italian government is particularly pushing in this direction, on the one hand to focus separately the investigation on different macro-typologies of taxpayers (big and medium enterprises, small enterprises and self-employed workers, non-commercial bodies, individuals), on the other hand to adopt different tax assessment instruments for each macro-typology[49].

With regard to national tax evasion, we have to underline the legislative amendment strengthening the assessment based on "inductive" factors (so-called "redditometro"), applicable to individuals. Through this instrument Tax Authorities can determine the taxpayer's total income through a "synthetic" assessment on the basis of inductive factors which estimate a higher income. Recent

member States 2010. Tax policy after the crisis, Working Paper 24, 2010.

[47] M. CAPRINO, *Torna il superbollo per Suv e sportive da 170 cavalli in su,* Il Sole 24 Ore, June 30, 2011.

[48] N. BARONE, *Robin Hood tax più pesante ed estesa all'eolico*, Il Sole 24 Ore, August 13, 2011.

[49] Ministerial memorandum n. 13/E of April 9, 2009.

legislation deeply changed this kind of assessment, by envisaging a list of elements identifying the taxpayer's ability to pay, upon which the assessment is based, consistent with new items of consumption and new taxpayers' economic practice[50]. The risk is the creation of an instrument which is not connected at all with reality, effecting only to stop consumption and consequently the economy[51].

Restrictions adopted towards non-operating companies are actually coherent with the functionalities of *redditometro*. Likewise, also restrictions towards goods which have been assigned to family members or partners without according to current market conditions are meant to reconnect goods to the legitimate owner and to avoid the matter of fictitious heading of the assets, actually used by partners, to companies instead. In particular, a 10,5% Ires rate increase has been decided for the non-operating companies.

Additional package actually puts companies which have been systemically unprofitable for more than three years in this category. Moreover, costs regarding company assets which are leased to partners or family members of the entrepreneur at an annual fee below the market value are not liable to deduction from the taxable amount. Users are actually taxed on the difference between market rate and the amount paid for leased assets.

The data concerning to leased assets have to be communicated to the Italian Revenue Agency, who has to systematically control the users of the assets headed to companies. Under the new regulations, in order to proceed with synthetic reconstruction of the income of assets users, any method of company financing or capitalization will be taken into consideration[52].

[50] Ministerial memorandum n. 4/E of February 15, 2011.

[51] P. BOTTELLI, *Nel lusso ritorna il "cash"*, on *Il Sole 24 Ore*, April 12, 2011. The author underlines that the fear of tax assessment based on the so called "redditometro" is pushing people to go shopping abroad, i.e. Montecarlo.

[52] P. CEPPELLINI, R. LUGANO, *Il tentativo di «catturare» chi sfugge al redditometro*, Il Sole 24 Ore, September 3, 2011.

Moreover, again in order to contrast tax evasion, Italian Government has included a particular regulation in the additional package: according to it, having regard to data related to banking operations and after consulting associations of financial intermediaries, the Italian Revenue Agency can draw up specific selective lists of taxpayers to be assessed. With regard to international tax evasion, particular attention was paid to fight aggressive tax planning schemes, increasing the use of international tax cooperation[53].

At last, there was the need to change the estimated assessment based on the so-called "studi di settore" (a sort of "standardized" income according to the activity, to the characteristics and to the cost structure of the business) according to anti-crisis correctives, in order to modify economic data which were referred to previous years not hit by the crisis[54].

The Greek government also planned several interventions to fight tax evasion and tax avoidance, including the reorganization and modernization of the tax administration[55].

3. Tax policy strategies at the European level

Besides tax reforms implemented individually by the States in order to counter the crisis, there are fiscal measures to be necessarily or preferably implemented at the EU or supranational level.

Limiting the analysis to the EU level, the strengthening of "tax coordination" seems to be the correct answer to the weakening of the Single Market.

[53] Ministerial memorandum n. 20/E of April 16, 2010.

[54] Ministerial Decree of May 19, 2009. In particular, these correctives concern increase in row materials and in fuel costs and negative trends of several economic sectors also depending on the territory where the business is carried on.

[55] European Commission, *Taxation trends In the European Union*, 2010.

The lines of action suggested at the EU level are various.

First of all, answering to "Monti's Report" and to the "European Commission Communication 608 of 2010", the proposal of Directive on a Common Consolidated Corporate Tax Base, CCCTB was just published[56]. According to this document, the CCCTB is an important initiative on the path towards removing obstacles to the completion of the Single Market. The CCCTB is an optional system of common rules for computing the tax base of EU resident companies and of EU-located branches of third-country companies. Harmonization will only involve the computation of the tax base of companies with autonomous rules and will not interfere with national rules on financial accounting. The common approach will give consistency to the national tax systems but there is no intention to extend harmonization to the tax rates. Under the CCCTB, groups of companies will have to apply a single set of tax rules across the European Union and will have to deal with only one tax administration, with a stark reduction of *compliance costs*. Moreover, the CCCTB, in line with the rethinking of tax systems and the shift to more growth-friendly and green taxation, as advocated in the Europe 2020 strategy, provides that all costs relating to research and development are going to be deductible[57].

In point of fact, in the context of the crisis, this proposal does not only affect the lower tax burden for undertakings and the consequent increase of competitiveness, but it also touches upon one of the causes of the crisis, since harmonization of the rules will guarantee an "homogenous" reading of undertakings "fiscal data". As a matter of fact, the lack of transparency of these data strongly contributed to the crisis.

A second issue at the EU level is the will to realize a new VAT strategy on the basis of the Green Paper on the future of VAT we

[56] European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base,* COM (2011) 121/4.

[57] European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base,* COM (2011) 121/4.

already mentioned[58]. In fact, the aim of the Green Paper is to launch a broadly based debate with all the stakeholders on the evaluation of the current VAT system and the possible ways forward to strengthening its consistency with the single market and its capacity as a revenue raiser, whilst reducing the cost of compliance and to prevent, detect and stop VAT fraud. The document, divided between two major headings, faces respectively the principles of taxation of intra-EU transactions and the issues which need attention irrespective of any choice to be made on the intra-EU treatment. In this context, for example, the European Commission asks whether the existing exemptions are still current and if the current variation in the standard rate in the EU and the reduced rates still make sense. What we previously examined about the measures aimed at reducing taxation on labour and company income by increasing VAT rates should lead to give an affirmative answer to this last question.

A third issue is the necessity to generate new sources of tax financing[59]. On this issue the European Parliament has published the Resolution *"Innovative financing at global and European level"* where three different issues are analyzed[60].

Firstly, the EU Parliament points out the necessity to strengthen the efforts by the Member States, the EU and the international community to fight against tax avoidance and financial fraud. In fact, according to the EU Parliament, the damages caused by tax evasion and tax fraud in Europe are estimated at about EUR 200-250 billion every year and reducing tax fraud levels would help to reduce public deficits without increasing taxes.

Secondly, the EU Parliament proposes the introduction of a financial transaction tax (FTT) because, in addition to the higher

[58] European Commission, *Green Paper on the Future of VAT,* COM(2010)695, 2010.

[59] M. Monti, *A new strategy for the single market*, Report to the President of the European Commission Josè Manuel Barroso, 2010.

[60] European Parliament resolution of 8 March 2011 on *Innovative financing at global and European level*, P7_TA(2011)0080, 2011.

revenue, it would improve market efficiency, increase transparency, reduce excessive price volatility and create incentives for the financial sector to make long-term investments. In particular, a low-rate FTT could yield nearly EUR 200 billion per year at EU level and could help to tackle the highly damaging trading patterns in financial markets, such as some short-term transactions, and curb speculation. Even if the best solution is the introduction of an FTT at a global level, according to the EU Parliament it would be possible to start with the introduction of an FTT at EU level. However it seems that this solution may lead to many, undesirable, distortions.

Broadly speaking, in the current political discussion there are three possible approaches in order to tax the financial sector: a tax on financial institutions (bank levy), a tax on financial transactions (FTT) and a financial activities tax (FAT)[61]. The difference between a general FTT and a bank levy or the FAT is that FTT does not tax financial institutions, rather levying a tax on single financial transactions. Instead, the FAT and bank levy do put a burden on financial institutions each one in a different way. In fact, the tax base for a bank levy is the balance sheet of the financial institutions and, in particular, liabilities. The tax base for a FAT is profit and remuneration of financial companies and is taken from the loss and profit statements[62]. Moreover, an important difference between the FTT and the FAT is that the FAT seeks to target the value – added by the financial sector, while the FTT is directed at the transactions made on the markets[63].

Many economists are of the opinion that a *Tobin Tax*, which is levied on specific transactions, – or a more generic tax on

[61] B. CORTEZ, T. VOGEL, *A financial Transaction Tax for Europe?*, Ec Tax Review, 1, 2011.

[62] European Commission, *Staff Working Document on the Taxation of the Financial Sector*, COM (2010) 549, 2010.

[63] European Commission, *Staff Working Document on the Taxation of the Financial Sector*, COM (2010) 549, 2010.

financial transactions – is practicable at least for two reasons. On the one hand, it would have the capability to gather huge amounts of money to finance global public goods (a global 0.05% minimum tax would produce $ 655 billion). On the other hand, basing on a "tax responsibility" principle, this could constitute a substantial contribution by the financial sector to the cost of the crisis. There are also people who think that a bank levy could be the best solution. In particular, they think about a tax to be levied on financial short-term liabilities of banks, as already proposed by Germany. At the moment the EU is pushing for agreement on a global financial transaction tax.

Lastly the European Parliament proposes the introduction of a European carbon tax based on the "polluter-pays principle". According to the EU Parliament, a carbon tax might provide significant additional revenue, even if the main reason for introducing a carbon tax is to change behaviours and production structures. This is why the expected revenue will then diminish when production patterns shift towards sustainable and renewable energy sources[64].

At the EU level, while there is the need to strengthen the EU fiscal framework, it seems necessary to establish a high-level "Tax policy group", chaired by the Commission, with a mandate to produce, within one year, a roadmap for a strategic and pragmatic approach to tax policy issues, paying particular attention to combating tax fraud and tax havens, reinvigorating the code of conduct on business

[64] As already said the European Commission published on April 13, 2011 a proposal to amend the Energy Taxation Directive. The proposal will allow Member States to make the best possible use of taxation and support "sustainable growth". To do so, the European Commission proposes splitting the minimum tax rate into two parts: one would be based on CO2 emissions of the energy product (minimum carbon tax); the other one would be based on energy content of the energy products, European Commission, *Proposal for a Council Directive amending Directive 2003/96/CE restructuring the Community framework for the taxation of energy products and electricity,* COM (2011) 169/3, 2011.

taxation while making more extensive procedures against unfair tax competition, enlarge automatic exchange of information, facilitating the adoption of growth-enhancing tax reforms and exploring new instruments[65].

Finally, as for "tax coordination" we should mention the "reinforced cooperation" pursued by Germany and France. In particular, both countries intend to combine efforts to make it easier to pursue those initiatives aimed at promoting tax harmonization. This cooperation started with a comparison between French and German tax systems with the goal to harmonize corporate income tax and integrate economic and fiscal policy trends[66].

4. Conclusions

We examined how both at the EU and at national level the "tax perspective" played a fundamental role as a stimulus to overcome the crisis and as an instrument to avoid the repetition of the "fiscal causes" of the financial crisis. For this reason, tax policy will be crucial in the next future.

The crisis can in fact offer a double opportunity. Firstly, to rethink national tax systems and make them more "employment, environment and growth friendly"[67].

Secondly, to strengthen the European Union and the Single Market. In this respect, it is our opinion that this is the right moment to finally implement the concept of "tax coordination", being it the only way to increase fiscal integration among Member States

[65] D. Feio, *Report with recommendations to the Commission on improving economic governance and stability framework in EU, in particular in the euro zone*, A7-0282/2010.

[66] The report on the comparison between the French and the German tax systems is available at *http://www.ccomptes.fr/fr/CC/Theme-230.html.*

[67] European Commission, *Monitoring tax revenues and tax reforms in EU member States 2010. Tax policy after the crisis*, Working Paper 24, 2010.

while respecting national sovereignty and thus giving Member States the opportunity to adopt tax measures according to their needs and specificities.

Italy, after a first package which was seeming to align with other States' fiscal measures (see the elimination of losses carry-forward or the project for a new fiscal package) is actually changing direction, especially in regard to the additional package. In fact, as we have already underlined, there has been the implementation of several regulations which are only aimed at increasing an already high tax burden, especially if we consider that tax return is not targeted at a structural revision of fiscal system but to a balanced budget.

For this reason, a fundamental remark has to be underscored: the additional package has actually anticipated the introduction of revenues which would have been useful to finance structural modifications and which are in line with the delegated legislation on fiscal package to foster economic growth. They are also aimed at lighting fiscal burden on labour and on companies (broadly speaking), at reducing or eliminating Irap and at restructuring personal income taxation rates. The higher revenues, which have been introduced so far, will be instead directed to achieve the improvement of budget balance. For this reason, one may legitimately ask how the fiscal package project, so fundamental in overcoming the crisis, will be financed.

Moreover, apart from the financing method, the key point to underline is: in this very historical moment, Italy is facing such a critical situation that it is no longer possible to hide behind slogans or propaganda. An effective fiscal package deserves more than mere intentions to be implemented. A project needs to be developed and only at last we have to implement regulations, otherwise we are running the risk of not implementing a real fiscal package for the country, but only a series of nonlinear and discontinuous regulations which may lose in efficacy, may create confusion and do not give a necessary boost to overcome the crisis and to foster the economic recovery we cannot delay any more.

Exchange of Information, Tax Crimes and Legal Protection

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1. The economic framework. The globalised financial crisis. Reasons and consequences on international taxation

«*Globalisation*», the «*global village*», the «*economic liberalization*»: all new words, neologisms aimed at defining in a synthetic way the most impressive event of the present era. The main and recognised issue is the economic development and the parallel increase of the public revenue, but more specifically this led to a unique cross-borders economy without territorial boundaries, with economic players and taxpayers without a defined national identity.

Is this a good scenario? The answer would be "yes" if *all* is referred to the past, but it would be "no" if we think about all the negative issues derived from globalisation. The cost and consideration of globalisation are the increase of tax evasion, tax avoidance and... *tax criminality*, in a broad sense!

In order to face these negative issues, the first concern is to establish whether there are efficient means to fight them and, in particular,

whether it is possible to identify a relationship between inter-State exchange of tax information and financial crisis and the EU single market.

As for the second question the answer is again "yes". But since the time I have to explain the topic is quite short, I must face it in small doses, *in pills*.

We shall first start from the reasons of the financial crisis, which have always been and are manifold: they are partly known and partly still unknown and, in this respect, I make reference to the clear and sharp analysis made by Tulio Rosembuj in this occasion and to his very interesting monograph recently published *La crisis financiera y el arbitraje fiscal internacional*, El Fisco, Barcelona, 2011.

As for the *economic reasons*, in line with other scholars, I totally agree with the reasoning followed by Paolo Savona in his speech, in particular with his conclusion that highlights the lacking of domestic and international ethical standard rules.

As for the *institutional reasons*, from a global perspective we pay the absence of an international financial government: that is why today we have coined the term «*international governance*». In the European Union there is the same problem: the absence of a European federal government, which consists in an institutional "vacuum" originated, using an old term, by the *Directorate* manifestation of the dominant Member States. A dominant unruly ideology of the free market, the *invisible hand* of Adam Smith, the four fundamental freedoms, the *liberistic* or *liberalistic* approach, the lacking of a coherent and unitary fiscal policy, the absence of coordination within the set of fiscal means, and, finally, the enforcement of this policy "delegated" to the single Member States.

This analysis is shared by the most outstanding intellectual personalities with different ideological approaches, but obviously not by the national political powers. Same story at the international level, where the governance is still dominated by the national sovereignties and only partially limited by new forms of "soft law" (*e.g.* the various forums and meetings with the formula G-7, G-8, G-20 *etc.*).

Focusing on the European Union, we shall easily notice that in the current framework the various member States are unable to fight unilaterally tax evasion and tax avoidance in a effective way, also in the VAT sector, since the power of fiscal supervision is "splitted" among twenty-seven member States with twenty-seven administrative, substantial and procedural criminal systems, while the taxpayers is only one. With this contribution I would like to remark that the problem is not merely technical, but also political. In fact, the system is formally based on the *subsidiarity* principle, but substantially governed by the *sovereignty* principle.

The crucial point is therefore the challenge *globalisation vs. control*, which is one of the main causes of the global and European financial crisis. Currencies and financial capitals are free to move in a globalised world, but the means of control are able to intervene only within the national boundaries. Why? Mainly because of one of the fundamental and still active international law principles, the principle of territoriality in tax matter, which provides that *tax enforcement* is strictly limited to the borders of the national territory in token of State's sovereignty (so-called *active tax power*). In other words, each State has only the inland monopoly to enforce its law and punish through criminal, administrative or tax law the facts that come under its jurisdiction (so-called *passive tax power*).

Care and defence of national revenues are certainly based on the exchange of tax information, on mutual assistance in enquiry (*simultaneous tax investigations*) and mutual enforcement of tax judgments, but they must be accompanied together with the adjustments of domestic law to the international treaties signed among sovereign States. The legal basis of exchange of information and tax criminal cooperation relays on international bilateral conventions or also on multilateral treaties, although only few States are part of them (*e.g.* the *Convention on Mutual Administrative Assistance in Tax Matters*, signed in Strasbourg on January 25, 1988 and entered into force on April 1, 1995).

Nowadays we expect that in the next future the policy in judicial cooperation in tax crimes will surely be destined to improve more

and more according to the new anti-evasion and anti-tax-havens political commitments of the major world economies (*e.g.* the Obama program, Merkel, Sarkozy policies, the EU policy, the role of telematic exchanges *etc.*).

There are however many principles which obstacle the effectiveness of the present cooperation in tax criminal matters: the principle of speciality, of double criminality, of *ne bis in idem*, of proportionality, of *locus regit actum*, of reasonable connection, of reciprocity... an inextricable labyrinth composed by principles which belong more to the logic of sovereignty defence and less to an effective repression of tax crimes.

But there are further complications. All civilised countries recognise the above mentioned principles, but they adopt, apply and enforce them differently, under conditions of formal and rigorous procedural fulfilments. From a different point of view, but not less relevant, there are many differences of legal protection (*i.e.* during the judicial inquiry in the requested State, no automatic defence attorney is provided to the taxpayer of the requesting State).

All these principle are regularly enforced, although they are often ineffective. But the obstacles of sovereignty and inefficiency become insurmountable when the potential requested State (*i.e.* the State which should provide mutual assistance in the assessment of taxes) is a *tax haven* or, according to the new label, a *criminal paradise*. In this respect, we shall remark that the main and most successful instruments in criminal tax judicial assistance are adopted by the majority of States, but certain jurisdictions still behave as *non cooperative* players.

To sum up, the limits to the battle against international tax offences are: lack of harmonization and cooperative coordination, different interpretations and/or enforcement of the same tools, low efficiency and... chaos.

2. Something is changing: the new definition of *tax havens* and the "end of banking secrecy era"

The negative scenario which has been depicted has been nevertheless counterbalanced by certain recent developments in the international community.

Something has changed (and it is changing) as a reaction to the financial crisis, after the resolutions of the G-20 adopted in London on April 2, 2009, which gave the impulse to new important amendments in the latest version of the OECD Model Tax Convention (issued in July 2010): the new concept and definition of *tax havens*.

Differently from the traditional definition of tax haven, which identified jurisdiction with a low or zero level of taxation, nowadays that definition identified all those jurisdiction which do not exchange information (so-called *non cooperative jurisdictions*). The basic assumption is that if a jurisdiction does not want to exchange information in tax matters, this is an indirect signal that it has something to "hide" to the tax authority of the requesting State.

Parallely, the European Union adopted Council Directive No. 2011/16/EU of February 15, 2011 on administrative cooperation in the field of taxation, which repealed Directive No. 77/799/EEC. According to this instrument, the general principle on exchange of tax information and the consequential use in criminal proceedings provides that if a certain behaviour constitutes a tax crime and the information exchanged is also relevant for criminal purposes, then it *may* be used in the criminal proceeding if the requested State does not raise any objection. In other words, the "*transmigrability*" of tax information in criminal proceedings is now subject to such condition and this represents a significant step forward.

It is extremely interesting to read the motivation of the new EU Directive on exchange of information, contained in the Preamble.

The basic necessity that led to the approval of the new discipline is the full awareness of member States concerning the increasing difficulties of tax revenue controls, international double taxation,

exponential growth of tax evasion and tax avoidance and, finally, the various threats to the function of the internal market.

The other motivations are that members States are nowadays unable to manage autonomously and unilaterally their national tax systems, mainly in the field of direct taxes, without receiving information by the other member States.

States member or not of the EU finally reached their consciousness that, although each of them preserves rigorously its own criminal law system, there must be cooperation in judicial assistance. States are starting to realise that they cannot tackle effectively this phenomenon, in order to preserve *their own* economic system, without international cooperation.

A strong signal of this new change is the different attitude to face the so-called *banking secrecy*. The anti-tax havens strategy adopted by the G-20 of London shows an extraordinary increase of signature of *TIEA*s agreements shaped on the 2002 OECD Model on exchange of information, which does not find anymore the limit of banking secrecy, since *non cooperative jurisdictions* identified by OECD needed to reach a minimum target of 12 agreements providing exchange of information in order to esc from the so-called *black list*.

From April 2, 2009 to June 2011, the number of signed *Tax Information Exchange Agreements* (*TIEAs*) shifted from 65 to 680!

3. The inland behaviours of tax courts

Since we have no room to explain in a more deeply and analytic way this topic, it is interesting to check which is the first reaction at the national level to such change and which is the approach of national courts to the problem.

The practical effect of this new scenario is easily recognisable in the recent cases of United States of America vs. UBS, the increasing phenomenon of stolen lists of alleged tax evaders, the Liechtenstein affair (so called *Vaduz* list of 2008), the *Falciani* list, the *Pessina* list

(2009), which all find an interesting precedent in the *Kredietbank Luxembourg* case of 1993.

These cases show what we said before in § 1: how it is complicated to reconcile the requirements of economic freedoms, the control of tax evasion and avoidance and taxpayers' procedural and judicial fundamental rights.

This new trend shows a specific concern of the international community against the phenomena of tax evasion and tax avoidance, since the exchange of information shifted into a commerce of stolen lists of alleged tax evaders: this is a clear signal that the actual framework of exchange of information does not work efficiently.

At this point, we shall ask ourselves what kind of problems arise from these cases? The stolen lists are compatible with the compliance of a legal procedure? Is this administrative practice consistent with international treaties? Can we consider admissible the information obtained through this channel? Is bank secrecy an expression of the fundamental right of secrecy provided by art. 6 of the European Human Rights Convention? Which are the problems and the relationship between criminal and tax administrative procedures?

At a glance, my opinion and answer can be concisely expressed by an image, what I like to define the "*original sin*", which – in common law terms – relates to the so-called *fruit of the poisonous tree doctrine*. We may put the question in these terms: when the information formally comes from an official tax body (*i.e.* from the German tax authority or from a tax court to the correspondent Italian tax officers, the *Guardia di Finanza* or a tax court), according to EU law and in compliance with the relevant directives procedures or treaty provisions, no problem. The question is different when the information are obtained by the German tax authority (*Bundesnachrichtendienst*) from a private person in the Liechtenstein affair in an unlawful way (*i.e.* stolen list) and then forwarded to Italy. Does the original unlawfulness result and determine the incorrect information received by Italy (according to the Latin *vitiatur et vitiat* principle)? In other words, is there a *domino effect* of invalidity?

In this respect, we shall remark that on the grounds of the information collected in such way, a number of Italian, German and British taxpayers have been (and still are) inquired and assessed for tax offences. However, since Liechtenstein does not grant any judicial assistance in tax matters, except for particularly relevant criminal offences and in money laundering, such information could have not been used through official ways. Certain Italian tax courts recently argued that information obtained by an infringement (*i.e.* not through a formal rogatory letter) shall not be used to ground and justify a tax assessment.

Again, since that information represents inadmissible evidence from the perspective of a legal procedure, then did the EU member State infringe an international treaty provision, violate the right to privacy of its citizens and, in general, the right to a fair trial (art. 6 EHRC)? Is it possible to take action against the tax authority for damages? Can we consider that act of a Member State in line with the general principles of international treaty law of *pacta sunt servanda* and good faith?

The practice of inter-State exchange of unlawfully obtained tax information arises further ethical problems: is it morally acceptable to tackle a crime – in this case a tax crime – through another illegal behaviour (*the end justifies the means*)? Illegal vs. legal, the problem of lawfulness of tax amnesties: it is the same problem.

What now should be analysed is the complicated relationship between criminal and tax proceedings. In this respect, Italian tax law does not expressly provide the principle of not availability of evidence collected in violation of statutory prohibitions. So the problem is resolved by the Italian Supreme Court (hereinafter ISC) case law, but on the basis of general principles in three different interpretative trends. Firstly, tax assessments based on unlawfully obtained evidence shall be invalidated[1]. Secondly, unlawfully obtained proofs

[1] See: ISC, I Civil Chamber, decision of November 8, 1997, No. 11036; ISC, I Civil Chamber, decision of July 27, 1998, No. 7368; ISC, I Civil Chamber, decision of November 27, 1998, No. 12050; ISC, Tax Chamber, decision of February 26, 2001, No. 2775; ISC, Tax Chamber, decision of September 29, 2001, No. 15209; ISC, Tax Chamber, decision of December 3, 2001, No. 15230; ISC, Civil Grand Chamber, decision of November 21, 2002, No. 16424; ISC, Tax Chamber, decision of July 18, 2003, No. 11283.

shall be considered unusable and the tax assessment groundless[2]. Finally, unlawfully obtained proofs are in principle admissible, unless they contrast with a constitutionally protected right[3].

Which is the approach followed in the other member States? The first signal arrives by a recent judgment of the Court of Appeal of Paris[4], which annulled the orders issued in first instance and condemned the tax authority to refund the assessed taxpayer for violation and damage of his fundamental rights. The French judge acknowledged that the information was stolen, being them «*obtenues par la commission d'une infraction pénale*» and, using the words of the judgment, «*la transmission de ces données par le Procurer de la République de Nice à la DNEF au titre de l'article L 101 du LPF est irrégulière puisque cet article vise la communication par l'autorité judiciaire à l'administration des finances de toute indication qu'elle peut recueillir de nature à faire présumer une fraude en matière fiscale*». This last analysis shows a problem of illegal procedure.

We may see a similar reaction in the initial Italian case law on this issue. The Tax Court of first instance of Milan[5] and the Tax Court of

[2] See: ISC, Tax Chamber, decision of June 8, 2001, No. 7791; ISC, Tax Chamber, decision of June 19, 2001, No. 8344; ISC, Tax Chamber, decision of March 6, 2001, No. 3852; ISC, Tax Chamber, decision of April 1, 2003, No. 4987.

[3] See: ISC, Tax Chamber, decision of November 4, 2008, No. 26454; ISC, Tax Chamber, decision of February 19, 2009, No. 4001; ISC, Tax Chamber, decision of March 20, 2009, No. 6836.

[4] Cour d'Appel de Paris, Pôle 5 – Chambre 7, Ordonnance du 8 Février, 2011, with regard to the so-called *Falciani* list. In 2009, Mr Hervé Falciani disclosed to the Public Prosecutor of Nice a comprehensive list of clients of the HSBC Genève branch, containing over 80.000 names and financial information, which included 7.000 Italian taxpayers now under investigation by the Italian authorities. The list has been transmitted in two different copies, which are not identical, to Rome by the French Government and to Turin though a rogatory letter.

[5] Tax Court of First Instance of Milan, Section 40, decision of December 15, 2009, No. 367.

first instance of Mantua[6] held that tax assessments based on alleged behaviours of tax evasion emerged by the Liechtenstein list shall be declared invalid for a number of reasons:

- unclear legitimacy of the acquisition of evidence abroad, which has been probably obtained through a criminal offence (unusable);
- shift of a "diabolic" burden of proof on the taxpayer, since it would concern facts of which the taxpayer was not aware at the time the assessment was carried on.

The position of the Tax Court of first instance of Florence is quite different[7], since it held that if tax authorities obtain information or data by the Italian Tax Police (*Guardia di Finanza*) in absence of an express permission or outside the legal procedure, this does not make that evidence inadmissible. In fact, inadmissibility is a legal category used only in criminal law and its non usage in tax proceedings does not represent a Constitutional issue, since private interests protected by tax law are different from those protected by criminal law. Therefore, tax authorities shall ground their tax assessments on evidence obtained with any tool, *being the only limit its reliability*. The question will reach a clearer answer only when it will be faced by the ISC.

4. Conclusions

I move quickly to the conclusions. What lesson shall we imply from this changed approach to international tax cooperation? In principle we have to overcome bilateralism in tax treaties and, more recently, member States started to negotiate multilateral agreements in tax matters and providing judicial assistance, although in few of them they entered into force. Then new domestic measures and a better

[6] Tax Court of First Instance of Mantua, Section 1, decision of May 27, 2010, No. 137.

[7] Tax Court of First Instance of Florence, Section 16, decision of January 19, 2011, No. 11.

coordination among States in tax matters may lead to an effective strategy against the use of tax havens for tax frauds and tax evasion.

As for the European Union, I believe that at present harmonization of tax criminal *substantial* rules is still a matter of futurology. There are more chances for harmonizing tax criminal *procedural* rules. In order to achieve a real European common market, it is absolutely essential to safeguard fundamental human rights and, at the same time, tackle criminal behaviours (including tax crimes). For these reasons, the creation of an international and/or a European committee may be the answer and the solution to win this challenge (as also mentioned in the report by Tulio Rosembuj).

The whole mechanism of international cooperation through exchange of information will properly works only if States will give more attention to their citizens' rights protection. A great opportunity in this sense is the ratification of the Charter of Fundamental Rights and of the Protocol of the Treaty of Lisbon.

In synthesis, the examined case law shows that States' fiscal sovereignty is still the huge and main obstacle to the international legal globalized order. The overcoming of the principle of sovereignty, the abandon of the principle of the tax justice (which belongs to the ethical sphere) in a sole country, the ethical and cultural acquisition that tax crimes are not only crime for a single State, but it is an objective fact, an offence that affects the whole community and it shall be considered in the same way as the offence to a single person. In one word, the universal relevance of tax crimes would be not only a legal conquest, but also an important step for a more ethically-oriented global fiscal policy. According to Thomas Nagel and in contrast to the opinion of Thomas Hobbes, we must cherish the idea – although today only utopian – that a global (tax) justice in a right world is still possible[8].

[8] See: T. NAGEL, *The problem of global justice*, in *Philosophy and Public Affairs*, Vol. 33, No. 2/2005, pp. 113-147, Italian translation of G. Pellegrino, *È possibile una giustizia globale?*, 1st ed. Laterza, Rome-Bari, 2009. And see: M. WALZER, *Giustizia globale, solo una utopia?*, in *Vita e Pensiero*, n.4, 2011, pp. 16 ss.

New Trends on Business Taxation after the Crisis

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Table of contents: 1.- Introduction; 2.- Monti Report; 3.- European Stability Mechanism; 4.- Tax driven erosion of the financial position of enterprises; 5.- Horizontal supervision: a new relationship between taxpayers and the tax administration; 6.- Conclusions.

1. Introduction

On behalf of EUCOTAX, I would like to thank cordially the University of Luiss for hosting the EUCOTAX Wintercourse for the second time and for giving us such an excellent opportunity to do our work. 1999 was the first year in which the Wintercourse was in Rome; this year we are enjoying again the great facilities of LUISS University and the beautiful Roman climate and the fantastic Italian kitchen. Especially, I would like to thank professor Livia Salvini for the cooperation and professor Giuseppe Melis and professor Eugenio Ruggiero, who have contributed very much to the success of the Wintercourses of the last eleven years. Thank you very much for your great commitment to the EUCOTAX Wintercourse! Also, I would like to express our gratitude to our good friends Federico Rasi and Alessio Persiani, who have also done a great job in organising this year's Wintercourse.

In my speech I will address briefly some new trends on business taxation after the crisis. There is a saying 'you should never

waist a good crisis'. I think this is also true in respect of the actual financial and economic crisis. We can use this crisis to reform our tax systems, not only from a national perspective but also from a European and even a global point of view. An important question in this respect is whether taxes have contributed to this crisis. An even more important question is whether taxes can be used to overcome this crisis. I think the answers to both questions can be affirmative.

I do think that taxes have been detrimental to the economic development. First of all, this is connected to the different tax treatment of debt and equity. The many tax incentives for financing business activities with debts are an important reason why inter alia hedge firms have had such a big success. This has led to negative consequences for the capitalization of companies. Also, very liberal tax accounting rules have contributed to the financial and economic crisis. In this respect, I refer to the tax treatment of derivatives, especially to the possibility that exists in many countries to take losses with respect to financial instruments into account for tax reasons directly and to defer taxable profits until the moment of realization. This may conflict with the fact that in hedge accounting these losses and profits are very much connected. This imparity in the tax treatment of losses and profits encourages the behaviour of businesses to use derivatives as much as possible.

The way we have taxed stock option schemes and bonuses has also been an incentive for managers to compensate their activities with stock options. This has led to exceptional remuneration schemes for CEO's.

The challenge is how to use taxation in order to overcome these problems and to prevent them from happening in the future. Recently, a Member of Dutch Parliament has proposed to tax with retroactive effect bonuses of bank directors or CEO's of multinational companies at a rate of 100%. This person, who has been a tax lawyer, says that he is aware of the fact that this proposal is against all legal principles of taxation and of the rule of law.

But he claims that because we are in a crisis, we can ignore these principles. We have also discussed with the Wintercourse students the question whether it is allowed to ignore legal principles when there is a crisis. My answer to this question is: no, never! Principles are principles, in good times and in bad times. I truly hope you all agree.

2. Monti Report

Professor Giuseppe Melis has already mentioned the important report from professor Monti from May 2010 'A New Strategy for the Single Market'. Although Mario Monti is a professor, in his report he proposes very practical solutions and proposals. First, he says that we have to focus on what is going on in Europe at this moment. The EU should further eliminate tax barriers within the single market. In this respect, the EU has to modernise e-invoicing rules in the framework of VAT. If you want to have cross-border business, you must facilitate and simplify e-invoicing rules. I also refer to the recent Green Paper VAT. The EU should update the rules on cross border relief. There are still threats of double taxation, e.g., because of the lack of a possibility for relief with respect to withholding taxes. Also, exit taxes still exist, applicable especially in the area of companies. These exit taxes are probably in conflict with case law of the ECJ with respect to the freedom of establishment because they do not contain proportionate solutions for the prevention of the loss of taxes in the state of origin. Monti also proposes to introduce a binding dispute settlement mechanism covering double taxation. As long as there is double taxation within Europe, you can doubt whether there is a real single market. He also criticizes the savings directive: because there are so many loopholes in this directive, we still face the situation that the taxation of savings is far lower than the taxation on labour income. There are too many possibilities to evade taxes on

saving money. A very important proposal of Monti is also to implement a common definition of the corporate tax base and move forward with the work of the Code of Conduct Group on Buisiness Taxation. Two weeks ago, we have seen the introduction of a proposal for a directive with respect to the CCCTB.[1] Monti has also proposed to reform the VAT rules in a single market-friendly way. In this respect he aims at facilitating and harmonising the compliance rules. There are all kind of different rules in the 27 Member States and they can be simplified and harmonised. Besides, Monti has stressed the importance of environmental taxes. Nowadays, income from labour is taxed much higher than income from capital. We should try to achieve a better balance between indirect and direct taxes. Environmental taxes could be a good way to reduce the tax burden on labour income. Finally, Monti proposes to realize more tax coordination by establishing a tax policy group under the supervision of the Commissioner responsible for taxation in Europe. The idea is that Ministers and State Secretaries of Finance should meet on a regular basis in this Tax Policy Group in order to discuss tax coordination issues.

3. European Stability Mechanism

In the framework of the development of the European Stability Mechanism, also some tax proposals have been made. First, the combat of fraud and tax evasion has been stressed. Also, coordination of tax policy is considered to be a necessary development. Other elements are the encouragement of the exchange of information and best practices and the introduction of measures to prevent harmful tax practices. I already mentioned the proposal for the introduction of a CCCTB. In this respect, I remember the Wintercourse we organised in Budapest in 2008 at the Korvinus

[1] Com (2011), 121.

University. There, we had a conference in which we have discussed the CCCTB with the Commissioner responsible for the internal market at that time, Mr. Kovacs. We warned Mr. Kovacs for two elements in this proposal as it was at that time. The first warning referred to the relationship between tax accounting principles and financial accounting principles. In my contribution to this conference, I have stressed that IAS/IFRS should be the starting-point for the determination of the tax base of CCCTB.[2] The development of an autonomous tax base would lead to unnecessary legal uncertainty. The second issue had to do with the allocation criteria, necessary to divide the common tax base amongst the member states, so they can tax their piece of the pie at the national rates. One of the proposed allocation criteria are assets. Prof. Rosembuj warned that if you do not include intangibles in these assets, you are neglecting economic reality. Unfortunately, I must say that in the recently published draft directive CCCTB both warnings have been ignored by the European Commission. Fortunately, this is just a draft directive, so there is still a chance for amendments.

4. Tax driven erosion of the financial position of enterprises

A very important trend after the crisis is the acknowledgement of the fact that we should get rid of the tax driven excavation of the financial position of enterprises. We have to try to find a more equal tax treatment of debt and equity. Now, debt-financing is very much tax driven. Interest is considered to be a tax deductible business cost, whereas dividends are not deductible. There are many possible

[2] P. Essers and R. Russo, *The Precious Relationship between Tax Accounting and Financial Accounting*, in: P. Essers and others (editors), The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure, and Corporate Law Accounting Concepts ('A Clash of Cultures'), Kluwer Law International: EUCOTAX Series on European Taxation 2009, pp. 31-33.

solutions for this problem; I will mention three of them.[3] The first is to allow for corporate equity a deduction of a primary rent or primary dividend. In that case, the tax treatment of equity will be more in line with the treatment of debt. A disadvantage of this proposal is that it costs a lot of money because the tax base is going to be lower. This means states will have to find extra money in return. Some say that to compensate this loss of revenue, states will have to increase the corporate income tax rates. Of course, that is not attractive from a tax competition point of view. Another approach is the so-called Comprehensive Business Income Tax. Then, you deny the deduction of interest costs, especially interest costs paid within a group of companies. In the Netherlands, we have had a proposal, the group interest box, meaning that the received interests within a group of companies could be taxed at a very low rate. On the other hand, if you pay interest this interest would only be deductible against the same low rate. This system is only beneficial for taxpayers in international situations: the debtor deducts the interest outside the Netherlands against a high tax rate and the Dutch creditor is taxed for the received interest at a low rate. This might be considered as an example of unfair tax competition. I do not really have a preference for either the allowance for corporate equity approach or the comprehensive business income tax approach. The only precondition is that you must apply these systems world-wide, or at least within the EU. If only one country applies one of these systems, you will always face either tax avoidance or double deductions on the one hand ör double taxation on the other hand. Double taxation will occur if interest is no longer deductible in the country of the debtor, but taxed in the country of the creditor. So, I'm rather neutral towards these two solutions, provided you implement one of these systems in a global or at least a European context. The

[3] See also: P. ESSERS AND OTHERS (editors), *Reforming the Law on Business Organizations, Back to Basics in Business Law and Tax Law*, Eleven International Publishing 2011, pp. 141-149.

last possibility I will discuss to tackle the problem of tax erosion because of thin capitalization, is a system based on the fundamental application of the principle of origin. Professor Eric Kemmeren is one of the advocates of this system.[4] The idea is that it is perfectly all right to allow an interest deduction to the debtor company. Interest can be considered as a business cost, so the denial of the deduction of interest costs, is in conflict with sound business practice and commercial rules. After you have allowed the debtor to deduct the interest, the creditor will be taxed on the received interest, because for the creditor the received interest is considered to be taxable income. A group of companies can only realize a tax benefit if the group debtor is situated in a high taxing country, deducting the interest at a high corporate income tax rate, and the group creditor is situated in a low taxing country. In that case the group realizes at the level of the debtor company a deduction of interest against a high corporate income tax rate, whereas the receiver of the interest, the creditor company, is taxed against a low rate. This is the actual situation, used many times in international tax planning. However, if the principle of origin were to be applied, the received interest would be taxable in the country of origin, the country of the group debtor. This means that the country in which the debtor deducts the interest would also be the country that is entitled to tax the received interest by the creditor company, as if the loan were a permanent establishment. Then, the game of international tax planning is over, because this game is all about tax arbitrage. If you deduct and tax the interest at the same rate, there will be no incentive for tax avoidance anymore. Of course, it is still a long way to implement this system – all double tax treaties have to be amended – but the same was true for the establishment of the European Union or even EUCOTAX. You must have dreams in order to achieve concrete solutions!

[4] E.C.C.M. KEMMEREN, *Source of Income in Globalizing Economies*, Bulletin for International Fiscal Documentation, Vol. 60, No. 11, 2006.

5. Horizontal supervision: a new relationship between taxpayers and the tax administration

Finally, I would like to draw attention to a really revolutionary development in my country, the Netherlands. This development has to do with horizontal supervision, based on trust and compliance.[5] In Rome, at the bar of LUISS, I found a similar application of trust and horizontal supervision. At lunchtime, I went to this bar, where I ordered Panini and some drinks. Then, I went outside because I wanted to enjoy my Panini at the terrace. I did not pay and no-one asked me to do so. After having enjoyed the Panini, I returned in order to pay, although I had the opportunity to leave without paying. But I returned and paid my Panini and drinks. I am sure all of you would have done the same. What does this mean? The management of the bar of Luiss University could have decided to put two employees or Carabinieri at the exit of the bar. That would have cost far more money than the costs of two or three customers in a month not willing to pay. My thesis is: most of the taxpayers are honest taxpayers. Although companies don't like to pay taxes, they accept this duty. What they really want however, is to get certainty on beforehand. The most important thing for them is to have certainty on the tax amount they have to pay. They consider taxes as part of the cost price. This is the idea of horizontal supervision: treat decent taxpayers in a decent way. The tax administration should not apply the standard of a bad taxpayer to decent taxpayers. So, the idea is that the tax administration gives decent taxpayers – companies, businesses – the opportunity to be their own judge. They are primarily responsible for their own tax position. They have to mention voluntarily possible risks to the tax inspector. In return, the tax inspector will treat these taxpayers as decent persons. He will

[5] P. ESSERS AND OTHERS (editors), *Reforming the Law on Business Organizations, Back to Basics in Business Law and Tax Law*, Eleven International Publishing 2011, pp. 165-166.

no longer send them long questionnaires about what has happened in the past. These questionnaires cost a lot of money because they heavily increase the administrative burden of companies. Instead, both the taxpayer and the tax inspector should work in the present and discuss the tax impact of business plans for the future. It means a shift from retrospective and repressive control to mutual respect, trust and transparency. To realize this, the tax administration and the executive board of the company conclude an agreement, a so-called 'enforcement covenant'. In this agreement the company promises to partly take over tax supervision based on a 'tax control framework', approved by the tax administration. Besides, the company will present proactively tax risks and will no longer apply aggressive tax planning schemes in order to explore the boundaries of the law. In exchange, the tax administration will provide advanced certainty and will no longer send long questionnaires. By doing this, the tax inspector and the taxpayer will discuss current instead of past events. Then, there will be less need for time-consuming retrospective audits by the tax administration or tax procedures.

However, if the tax inspector finds out that the taxpayer is cheating or that he is inclined to aggressive tax planning, the horizontal supervision will be changed into vertical supervision. The taxpayer can also freely opt for vertical supervision if he feels more at ease with this concept. In that case one falls back to the old, traditional hierarchy between the tax administration and the taxpayer. By using this concept of horizontal supervision and enforcement covenants, the administrative compliance costs of firms decrease significantly. On the other hand, the tax administration wins extra capacity to tackle the bad taxpayers and tax evasion. Thus, horizontal supervision leads to a more efficient use of limited capacity. It will also lead to more stable tax revenues. Of course, the concept of horizontal supervision also has some disadvantages. By applying this system, the taxpayer might become more dependent on the tax inspector. If the tax administration cancels the enforcement covenant, this might be bad news for the stakeholders of the company. Also, companies face

the risk of more internal bureaucracy because of the implementation and application of the tax control framework. A risk for the tax administration is that the tax inspector will have to give clearance in time, which may ask for extra capacity, knowledge and experience. Also, the equality principle demands that there should not be a too big difference in treatment between taxpayers that fall under horizontal supervision and taxpayers that fall under vertical supervision. In general, I think horizontal supervision could lead to a new trend on business taxation after the crisis, in which tax administrations make a division between the white sheep and the black sheep of the taxpayers. The white sheep should be entitled to a fair treatment and to horizontal supervision, in order to give them more advanced certainty and to reduce their administrative business costs. In return, tax administrations will have more time and capacity to tackle the black sheep. This development relates to the development of the idea that tax planning is no longer a pure technical issue; it is connected with reputation and responsibility of the taxpayers. As a result, tax planning has become part of corporate social responsibility. This means that also social and ethical aspects of tax planning have to be taken into account.

6. Conclusions

Both the Monti Report and the European Stability Mechanism highlight new trends on business taxation after the crisis. They stress the importance of eliminating tax barriers within the single market, the introduction of the CCCTB, environmental taxes, the combat of fraud and tax evasion, exchange of information and of best practices and eliminating harmful tax competition. Another very important trend after the crisis is the acknowledgement of the fact that we should get rid of the tax driven excavation of the financial position of enterprises. We have to try to find global or at least EU solutions in order to achieve a more equal tax treatment of debt and equity. Finally,

also the relationship between taxpayers and tax administrations deserves attention. The concept of horizontal supervision means a shift from retrospective and repressive control to mutual respect, trust and transparency. This could lead to a significant decrease of administrative costs both for taxpayers and for tax administrations.

Tax Incentives for Home Ownership in The United States: Good Intentions and the Financial Meltdown

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Table of contents: 1.- Introduction; 2.- Untaxed income; 3.- Imputed income; 4.- Gain from sale of personal residence; 5.- Deductions; 6.- Real estate taxes; 7.- Interest on residential debt; 8.- Tax responses to the financial crisis; 9.- Credit for certain home purchasers; 10.- Additional deduction for real estate taxes; 11.- Relief for owners of "under water" properties; 12.- Conclusions.

1. Introduction

It is widely acknowledged that the housing boom and bust in the United States contributed substantially to the worldwide financial disaster that evolved in 2008 and 2009 and that continues to this time. The impact of the collapse of the housing market had both a direct and indirect effect on financial institutions around the world. Many lenders had made loans to borrowers whose qualifications were doubtful. Further, many of these loans were bundled into financial derivatives in ways that, as it turned out, were highly likely to fail.

There are many factors that contributed to the boom and bust in the housing market in the United States. However, there is no doubt that the establishment of considerable tax incentives led over the years to a substantial investment in home ownership in the United States. As is often the case, the result was accompanied by the proverbial good news and bad news. All governments are concerned

to assure that the housing needs of their countries can be met. The tax incentives created by Congress clearly stimulated investment in the ownership of personal residences. However, many economists and other analysts have argued that individuals in the United States are too heavily invested in home ownership, at the expense of other forms of investment that might provide greater long-term economic development.

The rationale leading to the adoption of the tax incentives to invest in residential property found widespread acceptance in the United States. Political leaders across the political spectrum have long been enamored with the perceived social benefits of home ownership. For example, President William J. Clinton said in 1995 that "*When we boost the number of homeowners in our country, we strengthen our economy, create jobs, build up the middle class, and build better citizens*". These observations were quite unremarkable as they echoed similar observations by other political leaders over many years.

There are many political and economic factors that contributed to the debacle in the U.S. housing market. They include Congressional encouragement of lending to high risk borrowers and the expansion of a conduit for home loans to a governmentally sponsored entities. Such fascinating and important considerations are, however, beyond the scope of this paper. The limited purpose of this presentation is primarily to describe the several ways in which United States income tax law and policy was tailored to encourage more investment in home ownership. There is no attempt made here to estimate the specific degree to which these incentives have contributed to the financial meltdown or, for that matter, to the cost in terms of lost federal revenues that have resulted from them. A subsidiary purpose for the paper is to describe a number of tax measures adopted by the U.S. Congress in the midst of the crisis intended to provided support for the housing market and to mitigate the effects of its collapse.

2. Untaxed income

In several respects the income produced, conceptually or financially, from the ownership of a principal residence goes untaxed in the United States. The two most obvious examples of this phenomenon are the failure to tax imputed income and the exclusion from tax on certain gains realized from the sale of a personal residence.

3. Imputed income

Imputed income deriving from the performance of services for one's self or the use of one's own property is almost never subject to taxation in most countries, and is not taxed in the United States. The result is obviously a diminution of horizontal equity–the idea that taxpayers occupying similar or congruent economic circumstances should bear similar or congruent tax burdens.

In some instances the failure to tax such income might be regarded as a rather trivial matter. The cost and value of housing, however, can create substantial differences in tax burdens. For example, suppose that Taxpayers A and B acquire houses for $100,000. A lives in his house. B rents her house to another for $1,000 a month. At the end of the year, A has enjoyed the use of property. Such usage is worth $12,000, but there is no tax. B has realized $12,000 of rental income, which is fully taxed. B must then pay to rent her residence. If the tax rate is 35 percent (which is the maximum nominal marginal rate of tax under current U.S. law), B would have only $7,800 available to pay for her housing[1].

[1] Of course, this simple arithmetic is somewhat complicated by the availability of a depreciation allowance to B that will reduce her tax on the rental income. Under current law, the cost of the house (but not the land upon which is was constructed) could be depreciated on a straight-line basis over 27.5 years. Code Sec. 168.

The rental value of taxpayer-owned housing has been subject to tax in some countries. But no serious consideration has been given to such a tax in the United States. This failure to create a degree of horizontal equity is just the first first step in identifying tax incentives for home ownership.

4. Gain from sale of personal residence

The Internal Revenue Code (the "Code" is the principal legislative source of federal tax law in the United States) has long provided beneficial treatment for gains realized from the sale or other disposition of a principal residence. For many years, such gain could be excluded from tax as long as the taxpayer reinvested the proceeds of the sale in the purchase of a new principal residence within a specified period of the sale of the first residence[2]. The tax basis of the new residence would in part carryover from the tax basis of the old, so the arrangement was usually described as a deferral arrangement. However, when a taxpayer reached the age of 55, he/she was entitled to a once-in-a-lifetime exclusion that eventually amounted to $125,000[3]. The result of this arrangement was that a taxpayer could purchase increasingly costly residences without tax on gains realized from the disposition of the old residence. Then, perhaps when children had left the home and a smaller residence seemed appropriate, at least a portion of the profit attributable to the ownership of principal residences would escape tax altogether.

This regime was replaced some years ago by a generous exclusion from tax for gains attributable to the sale or exchange of a principal residence on an indefinite number of transactions. Section 121 of the Code provides for such an exclusion for up to $250,000 ($500,000 in the case of married couples) every time a principal residence is sold.

[2] Former Code Sec. 1034.

[3] Former Code Sec. 121.

There is one rather modest limitation on the exclusion. A taxpayer can only benefit from the exclusion once every two years. The exclusion is even available in circumstances when the property may also have been used for investment purposes. To qualify for the exclusion, it is only required that the taxpayer used the property as a principal residence for two years during the five-year period preceding the sale or exchange of the property.

5. Deductions

"Personal, living or family expenses" are generally not deductible under U.S. tax law[4]. However, the Code provides for a number of personal deductions, which are available even though the expenditure or loss is not attributable to income seeking activities. Several such personal deductions were designed to encourage and support home ownership.

6. Real estate taxes

Real property taxes, primarily applicable to land and buildings, are imposed by local and state governments throughout the United States. Section 164(a) of the Code provides that taxpayers are entitled to a deduction for "State and local, and foreign, real property taxes." That means that real property taxes paid in respect of home ownership will be deducted in the calculation of the federal income tax liability[5].

The deduction for real property taxes obviously creates material advantages for homeowners. By contrast, renters are entitled to no

[4] Code. Sec. 262.

[5] State and local personal property and income taxes (or, in the alternative to income taxes, sales taxes) are also deductible.

such deduction even though a portion of their rental payments has gone to the payment of real estate taxes by the landlord. Several years ago Congress rejected a proposal sponsored by a Senator from New York (New York City has many renters) to allow a deduction for the portion of rent paid by tenants that indirectly financed the payment of real estate taxes by the landlord.

7. Interest on residential debt

At one time, taxpayers in the United States were allowed to deduct almost all interest expenses regardless of the reason for which the debt had been incurred. Under present law, interest expenses can be deducted only if explicitly authorized by the Code. Section 163(h)(3) provides that "qualified residence interest" is deductible, but certain limitations apply.

Qualified residence interest is defined to include "acquisition indebtedness" and "home equity indebtedness". Acquisition indebtedness is debt incurred in "acquiring, constructing, or substantially improving any qualified residence of the taxpayer" that is secured by such residence. Such debt is obviously incurred actually to finance the taxpayer's residence.

Home equity indebtedness is defined to be any other indebtedness that is secured by the taxpayer's residence. It is not necessary that the proceeds of the debt be used in connection with the home ownership. Thus, the deduction is available to support any debt, regardless of the purposes of the loan.

There are dollar limits on the magnitude of eligible debt in both categories. Eligible acquisition indebtedness can not exceed $1,000,000. Eligible home equity indebtedness can not exceed $100,000.

The scope of the benefits provided by Section 163 is particularly large. A "qualified residence" is defined to include not only the actual principal residence of the taxpayer, but also "one other residence

[...] selected by the taxpayer" for purposes of the interest deduction. Thus, debt associated with vacation properties can also give rise to an interest deduction. In fact, since a "residence" is considered to be any dwelling with a kitchen, toilet and sleeping place, a boat, house trailer or mobile home can qualify[6]. Moreover, certain administrative costs imposed upon the borrower may also be counted as interest and, therefore, be deducted.

The extent to which this provision has been exploited is substantial. A recently published study indicated that 75.13% of the total household debt borne by individuals in the United States is "home mortgage debt"[7]. The interest deduction is, moreover, one of the largest tax expenditures in the United States budget.

8. Tax responses to the financial crisis

Having established tax provisions encouraging investment in home ownership, which undoubtedly contributed to the housing boom, Congress returned to the tax law to try to soften the impact of the financial disaster on certain taxpayers and on the housing market.

9. Credit for certain home purchasers

As a partial reaction to the devastated housing market in the United States, Congress adopted a credit for "first time homebuyers." Eligible taxpayers who purchased a first home between April 9, 2008, and June 30, 2009, were entitled to a credit equal to 10 percent of the cost of the home with a limitation of $7,500. Under this rather complex provision, the taxpayer is required to repay the amount of the

[6] See Temp. Reg. Sec. 1.163-10T(p)(3)(iii).

[7] Staff of the Joint Committee on Taxation, "Present Law and Background Relating to Tax Treatment of Household Debt," JCX-40-11 (July 11, 2011).

credit over a 15 year period beginning in the second year after the purchase was made. The net effect is, thus, a no-interest loan.

The idea of such a credit was extended by legislation adopted in 2009 for home purchases by eligible taxpayers prior to October 1, 2010. Moreover, the maximum credit was increased to $8,000. Under the new provisions, however, the amount of the credit did not have to be repaid.

A credit for "long-term" residents was also established in 2008. Under these provisions, a taxpayer who had lived in the same residence for at least five consecutive years could qualify for a credit of 10 percent of the purchase price of a new home, up to $6,500[8].

The credits provided by these provisions were fully refundable. Thus, if the tax liability was less than the amount of the applicable credit, the Treasury would make a payment to the taxpayer. Eligibility for the credit was phased out for taxpayers with higher incomes.

The rationale for these credits is quite clear. Congress believed that the credits would stimulate demand for housing at a time when the market peculiarly soft. The extent to which these credits may have stimulated market activity is not clear at this time.

10. Additional deduction for real estate taxes

Under U.S. law, a taxpayer may elect to take a "standard deduction" in lieu of specific personal deductions, such as the deduction for certain taxes. The standard deduction does not depend upon the incursion of actual expenses or losses, but is simply an arithmetic reduction in the determination of taxable income. The standard deduction is indexed to inflation. For 2010, the standard deduction for single taxpayers was $5,7000 and for married taxpayers filing a joint Tax return was $11,400. That meant that such taxpayers who had

[8] Code Sec. 36.

fewer actual deductions could simply elect to subtract that amount in the calculation of their income tax liability.

As the standard deduction is an alternative to the deduction of actual expenses and losses, a taxpayer electing the standard deduction cannot normally also deduct real estate taxes. However, Congress adopted legislation providing that for tax years beginning in 2008 and 2009, a taxpayer could elect to take the standard deduction, and also deduct real estate taxes up to $500 for individuals and $1,000 for married taxpayers filing a joint return[9].

11. Relief for owners of "under water" properties

A term that has been used with (unfortunately) increasing frequency during the financial crisis is the "under water mortgage." The term is used to describe the increasingly common phenomenon that the fair market value of a property is less than the amount of the loan obligation which it secures. Congress adopted a somewhat complicated provision designed to provide tax relief to taxpayers owning such property when the indebtedness is discharged without a full payment of principal and interest.

To understand the effect of the relief provision, it is necessary to explore some background information about the treatment of situations in which debt is eliminated without full payment. The Supreme Court many years ago determined that "cancellation of debt" was generally included in the gross income of a taxpayer[10]. That principle was later codified in Section 61(a)(12) of the Code for solvent taxpayers.

This principle could be applied to require income recognition for a taxpayer whose residence was seized by a lender at a time when its fair market value was less than its cost. For example,

[9] Former Code Sec. 63(c)(1)(C).

[10] U.S. v. Kirby Lumber Co, 284 U.S. 1 (1931).

suppose that a taxpayer purchased a residence for $100,000, borrowed $90,000 in a nonrecourse loan to finance the acquisition and pledged the residence as security for the debt. Suppose further that the value of the residence had fallen to $60,000 and that the taxpayer had chosen to default on the loan. The lender seizes the property and the debt of $90,000 is eliminated because the lender cannot pursue other assets of the taxpayer. The effect of the series of events would be that the taxpayer realized a loss of $40,000 ($100,000 basis less $60,000 proceeds) on the disposition of the residence and cancellation indebtedness income of $30,000 ($90,000 of debt less $60,000 payment). The loss on the disposition of the residence would not be deductible; but the income attributable to the discharge of the debt would be considered to be income subject to tax.

A series of relief provisions had been adopted over the years so that discharge of indebtedness income is not recognized in certain situations[11]. During the financial crisis, Congress expanded the relief measures to include "home mortgage debt forgiveness" arising prior to the end of 2012.

The relief provision effectively works as a deferral measure in many instances. If an eligible taxpayer realizes gain from the discharge of indebtedness, it will not be recognized in the year of the discharge. In the example discussed in the previous paragraph, the $30,000 of income realized by the taxpayer at the time of the discharge of his debt would not be taxed at the time. However, the taxpayer will suffer the reduction of a series of "tax attributes" intended effectively to make up for the taxes saved in the year of the discharge. As a result, certain deductions and/or credits will not be available in future years for taxpayers who have benefited from the non-recognition provisions. The amount of the potential exclusion is limited to $2,000,000. If a portion of the debt is discharged and the taxpayer continues to own the residence, the tax basis of the residence

[11] Code Sec. 108.

is generally reduced by the excluded amount[12]. However, no negative basis can result from such a reduction.

12. Conclusions

The Internal Revenue Code is extremely complex. Much of the complexity arises from the propensity of the Congress to use taxing provisions to advance governmental objectives that go far beyond revenue production. The encouragement of home ownership is just one, though a rather dramatic, example of this propensity. The incentives worked. U.S. citizens and residents have responded by investing heavily in home ownership. Until the past decade, it has been a good investment. Real estate values increased rather steadily for the 55 or 60 years following the end of World War II. The rate of increase in value in the early 2000's was particularly dramatic. It was appropriately characterized as a boom; and some predicted a bust. They were right. One might say that the success of the substantial incentives to invest in home ownership provide yet another example of the law of unintended consequences. One might also hope that political leaders will learn from such experience. In the case of the United States political process, such hope springs eternal; but it is unlikely to be realized.

[12] Code Sec. 108(h)(1).

The French Reaction to the Crisis

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I am very much aware that everybody is very tired and has been listening to a lot of speeches, but I will try to be as short as possible to present the French approach to the crisis.

What kind of crisis are we talking about?

We are always talking about the financial crisis but there is actually something more than a "financial" crisis.

The proper way to consider what has been going on since 2008 consists in saying that we not only experiencing the financial crisis but, more generally, a budgetary crisis, an investment crisis and a moral crisis.

A budgetary crisis: this is more than obvious. Public deficits have risen incredibly and France is also affected by this trend. An investment crisis because, as a consequence of the lack of bank financing, firms have had much more difficulty in investing, borrowing and of course they have been much more afraid of the future so they have invested much less, which has created a growth problem. A moral crisis, because nobody really trusts anybody anymore. We don't trust the State anymore, we don't trust the banks anymore, banks don't trust themselves anymore. Everybody has lost the sense of what morale is and how to behave correctly. The reason why I'm insisting on all that as a starting point is because the reaction to the crisis is a reaction to all of these aspects of the crisis.

Because we are talking about morality in a certain way, the first reaction has been to define who is guilty for the crisis and to tax the guilty.

The first reaction is: "let's levy a new tax on banks", because they are the ones which introduced risk in the global system. This is why the French bank levy was introduced in early 2011. It is not a French peculiarity, as has been said by Giuseppe Melis earlier. Germany has done that, Great Britain has done that. Actually, when you look at the three bank levies, you can see that there are substantial differences between these levies. The French one is not as harsh as the British one for instance. For instance, we don't tax French branches of foreign banks whereas the Brits do that, which by the way raises some issues concerning EU law.

Another decision that has been made is to increase control on remunerations and the way to control remunerations is very interesting from the French perspective. We don't like traders to be paid too much. Instead of saying, "well, you can't deduct the remuneration of traders anymore" we said "ok, if you banks decide to pay traders at a very high level, we will levy a specific tax on you banks because you pay this trader too much". This tax is also affected to a special reserve that will help healing the financial sector in the future.

We have also introduced specific restrictions to deductibility for some remunerations paid to CEOs such as golden parachutes, deferred pension schemes etcetera.

After taxing the guilty the second reaction is to protect the victims of the crisis. Who are the victims?

The victims first of all are the companies, they desperately need money, they need to have cash. This is why the State decided to accelerate the reimbursement of their credits. We have a carry back possibility in France and that is normally used as a credit against the State but you are not entitled to an immediate reimbursement of the credit. Well, in that case the State decided for a limited period of time to immediately refund the credit and the same goes for the research tax credit.

The next victim is the State. Everybody has talked about the need to fight tax fraud in a more efficient way and what is

happening in France is probably comparable in many respects to what is happening in other countries. But I'd like to say something else and to come back to what Claudio Sacchetto has said earlier concerning criminal cooperation. You might know that there is a European council framework decision of October 6, 2006 which already provides for a principle of mutual recognition of confiscation orders issued by criminal courts and that also applies to criminal actions in the case of tax fraud (tax fraud being intended here as a criminal offence). Therefore, if a criminal court in one country decides to confiscate an asset which is located in an other EU member State, that member State can not refuse to execute the confiscation order even though the criminal offence just does not exist in the requested country. This is a mutual recognition mechanism which goes extremely far and which now has been ratified in the French law.

There is however not a lot to expect from international cooperation in other fields. Giuseppe Melis alluded earlier to the informal cooperation process between France and Germany. Honestly speaking, there is not much to expect from that. A report has indeed been commissioned by the French president because he wanted to have an excuse to reform the wealth tax. He thought that since the wealth tax has been suspended in Germany, we could do the same in France. The Court of Accounts did produce this report, but the Germans didn't seem to be very interested by this dynamic approach of cooperation except maybe concerning corporate income tax but that's because the CCCTB was also advancing on a parallel way.

Thoughts for the future: the first problem is growth. There are a lot of questions going on now whether we should stop proving excessive incentives and tax breaks for multinationals. That is a big issue in France right now.

You might know that in France we have a cross-border consolidation system that is operating worldwide. There have been repeated attempts to repeal it, because it is perceived to offer too many tax

opportunities for multinational group of companies. These attempts have been unsuccessful up to now.

Another issue that is extremely boiling now in France is to to find the appropriate ways to provide an incentive for people to invest in productive economy. If we want growth to happen, we need people to fund companies. And that's where the crisis has risen an interesting issue with respect to risk and taxation. On the one hand, we don't want banks to conduct risky operations because that's partially the cause of the crisis. On the other hand, if nobody takes risk anymore there is not going to be growth anymore. So that is the whole issue to deal with and some people now are saying we should give specific incentives for long term investment for companies and for individuals who invest in companies. How can we do that? For instance, by providing capital gain exemptions when you sell shares that you have acquired a long time ago. Or you can force life insurance companies to invest at least part of their assets in small and medium enterprises. The crisis has therefore triggered new and interesting debates which are going to be in the core of the presidential campaign in 2012.

The German Reaction to the Crisis

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1. The impact of the financial crisis of 2008/2009 on the German economy and banking sector

As with the economies of other European countries and the US, the so-called financial crisis which followed the breakdown of the securitisation markets and the bankruptcy of Lehman Brothers affected the German economy in two ways. Firstly, it of course had a great impact on the banking sector, as it led to huge write-offs for asset-backed securities and a collapse of the interbank market. Although with hindsight the German banking sector proved to be comparatively solid, some financial institutions would have collapsed without the intervention of the Federal Fund for the Stabilization of the Financial Market (known as SoFFin[1]).Secondly, the German economy as a whole was severely affected by the economic crisis which followed

[1] Sonderfonds für Finanzmarktstabilisierung. SoFFin is based on the Financial Market Stabilization Act (Finanzmarktstabilisierungsgesetz), BGBl 2008 I, pp. 1982 et seq.

the financial crisis. In 2009 the German GDP (which in 2008 was still growing at a rate of 1.0%) fell by 4.7%, which was unique in the history of the Federal Republic. In 2010 the German economy grew at a rate of 3.6%.

2. Reaction to the crisis

Consequently, the German reaction to the crisis included measures to stabilize the banking sector (1) as well as measures to stimulate the depressed economy (2).

2.1. Measures to stabilize the banking sector: SoFFin and bank levy

Due to the global interdependence of the banking sector, only a few measures were taken on a national basis, and most of these were short-term measures aimed at preventing German banks from becoming insolvent. As the disturbing situation of some major banks had demonstrated a lack of supervisory banking, supervisory banking was re-organised and tightened. Additionally, the German government took steps to strengthen the banking sector on an EU and international level *(for example, an amendment of the capital requirement directive corresponding to the Basel III agreement, and enhanced cooperation of supervisory authorities),* measures which are not part of this survey. As mentioned above, the main tool used to keep the German banking system alive was SoFFin. The fund was created on October 17, 2008 – only one month after the bankruptcy of Lehman Brothers. Remarkably, both houses of the German parliament passed the SoFFin Act on the same day, something which happens only very rarely. SoFFin was empowered to grant guarantees of up to € 400 billion to overcome liquidity squeezes. Moreover, in order to strengthen the equity basis of financial sector companies,

SoFFin was also able to recapitalize banks suffering financially. SoFFin was therefore equipped with an additional € 80 billion (in comparison: the budget of the Federal Republic in 2009 was € 338 billion). Additionally, some German federal states had to strengthen the capital basis of state-run *Landesbanken,* which in most cases are jointly owned by federal states and public saving banks and which had nearly failed due to hazardous investments on the securitization markets. It is worth mentioning that the nearly insolvent Hypo Real Estate Bank had to be fully nationalized – a unique incident in the history of post-war Germany. In addition to this, the federal state guarantee provided a savings guarantee to prevent bank-runs and further cash outflows.

The stabilization of the banking sector meant that the importance of Soffin sharply decreased, although as at August 31, 2011, it was still providing € 48 billion of guarantees and capital. The Fund for the Stabilization of the Financial Market is to be replaced by the Restructuring Fund, which will be capitalized by a bank levy. The Restructuring Fund will primarily avert the bankruptcy of financial institutions which are of systemic relevance. In this way, the German banking sector will be able to withstand a future crisis of the banking system without charging the governmental budget. The levy will be imposed on September 30, 2011 for the first time. The annual contribution of each bank will both depend on the volume of the bank's business and reflect the extent to which its business depends on the interbank market. The progressive rate of the levy is between 0.0002 per cent and 0.0004 per cent of the volume of the relevant liabilities. The amount of the levy also depends on the derivative activities of the bank; in this case the rate is 0.0015 per cent of the volume of the business. In order to ensure that the international competitiveness of Germany´s leading banks (especially Deutsche Bank and Commerzbank) is not affected too badly, the levy will not exceed 20 % of the bank´s annual profits. However, banks will have to pay a minimum levy of 5% of their regular profits. According to the Restructuring Act the capitalization of the fund will eventually

amount to € 70 billion, a figure which is not expected to be reached in the near future. The bank levy will not raise more than approximately € 1 billion a year.

2.2. Measures to stimulate the economy: Growth Acceleration Act and car scrapping scheme

To stimulate economic growth, the German Parliament has adopted the Growth Acceleration Act[2] which came into effect on 1st January 2010. It provides tax relief amounting to about € 8 billion per annum (which means an estimated tax relief of € 40 billion until the year 2014) and predominantly focuses on a reduction of the tax burden on companies. Lowering the tax burden for individuals should increase consumer spending. As the term "growth acceleration" suggests, the act did not aim to abolish tax rules which might have had any effect on financial crisis. On the contrary, the parliament decided to loosen the prerequisites which must be met in order to deduct interest payments from the assessment base. According to the so-called interest barrier rule, the deductibility of interest payments is limited if certain thresholds (amount of interest payments, relation between interest derived and interest paid) are exceeded. By increasing the thresholds, debt financing becomes more attractive. As a consequence, business financing could increasingly depend on financial markets; companies could therefore be severely affected in case of a new credit crunch.

Bearing in mind the extraordinary amount of finance which was provided to keep the financial system alive and to boost the economy, politicians naturally did not forget to demonstrate generosity to voters. For this purpose – and also to boost German car manufacturing – a € 5 billion so-called car scrapping scheme was

[2] Wachstumsbeschleunigungsgesetz of December 22, 2009, BGBl 2009 I, pp. 3950 et seq.

created. Not surprisingly, it led to a collapse of the second-hand car market, threatened the existence of garage owners, boosted the import of small cars and led to a slump of car sales in the consecutive years whilst only having a minor positive effect on the environment.

3. Steps to counter-finance the costs of the crisis

The economic slump of 2009 combined with the measures to stabilize the banking system and to boost the economy led to an enormous increase in the spending deficit. While the public authorities generated a small budget surplus in 2007 and 2008, the budget deficit both in 2009 and 2010 was more than 3.0 per cent of the German GDP. As an increase in taxation for individual consumers could not be introduced for political reasons, only a few measures to counter-finance the costs of the crisis were introduced. Such a measure was the introduction of an air transport tax[3] which will generate revenue of € 1 billion per annum. Moreover, the German parliament decided to introduce a tax on nuclear fuels (so-called *Brennelementesteuer*)[4]. In order to mitigate the effects of the tax on utilities, the coalition government and the operators of nuclear power plants agreed to postpone the abandoning of nuclear energy (however, this agreement was later cancelled as a consequence of the Fukushima incident). Apart from that, there are severe doubts as to whether the tax on nuclear fuels is in line with the German constitution.

As well as in other EU member states and the US, an increase of the top income tax rate is a subject for discussion. Moreover, the introduction of a wealth tax (which was abandoned for constitutional reasons in the mid-1990s) could be possible if the coalition government were to lose the next parliamentary election.

[3] Luftverkehrsteuergesetz of December 9, 2010, BGBl 2010 I, pp. 1885 et seq.
[4] Kernbrennstoffsteuergesetz of December 8, 2010, BGBl 2010 I, pp. 1804 et seq.

4. Summary and outlook

There is at least no obvious indication that the provisions of the German tax law have had any impact on the development of the financial crisis of 2008 and 2009. Consequently, changes in German tax law have aimed to improve the situation of companies and stimulate private spending. Indeed the German economy recovered comparatively quickly. However, overcoming the crisis of 2008 and 2009 (without considering the disturbing situation of some member states of the eurozone) has resulted in enormous costs. Sharing that burden will be a huge challenge for German politicians in the coming years.

The Structure of the Financial System in Europe: Roots for Crisis

Eugenio Ruggiero
Luiss Guido Carli

Although the financial crisis should not be blamed only on the conduct of financial intermediaries or on the insufficiency of prudential supervision, their behaviour has sometimes amplified the effects of the crisis, or it has helped to hide it, postponing its emergence.

A few factors should be considered:

a) the development of financial innovation often turned out to be means to avoid regulatory requirements (*e.g.* the development of the shadow banking system, the credit derivatives as credit insurance) or merely speculative techniques transferring wealth, rather than creating any new wealth (*e.g.* derivative instruments merely used for speculative purposes, substituting any hedging function);
b) accounting techniques developed towards criteria that often could not really accurately represent the going concern of firms, thus creating misleading representations of profits or losses (distant from the real economy);
c) institutions and firms raised their leverage ratio, with a view to increase profitability;
d) prudential supervision showed its limits for several reasons: *i)* it induced procyclicality; *ii)* it showed difficulties in measuring and representing the commitments and risks assumed by the intermediaries; *iii)* no proper uniform perimeter for supervision was defined; *iv)* capital requirements showed they are probably not

proper or sufficiently effective to cover for innovative financial instruments;

e) flaws took place in the business organization of financial firms, mainly in the relationship between the board and the officers: *i)* need for greater professional requirements specific to the financial industry; *ii)* need for more accurate risk management systems.

* * *

Therefore, reforming prudential supervision of financial intermediaries and banks, with a view to increase the trustworthiness of counterparties in the financial market, has become a primary objective to be reached in order to avoid future similar downturns.

Discussion has focused upon the following issues:

i) clearer definition of the perimeter of intermediaries to whom supervision is to be applied; inconsistencies in Europe have allowed a wide variety of credit firms to operate without being subject to effective supervision;

ii) more accurate use of supervisory techniques, reforming the newly introduced Basel II agreements towards the even stricter Basel III agreements;

iii) shift supervision at an international level; the supervisory situation in Europe is highly fragmented and heterogeneous; the response was the setting up of the new European System of Financial Supervision, whose effectiveness is to be verified: what stands out, as of now, is its high degree of complication.

Two concluding remarks with regard to where reform of financial supervision should be addressed. In the first place, finance should go back to serving the needs of the real economy and regulation should be set up to favor and accompany that. Secondly, in the financial area it often happens that self-regulation is advocated to be more effective than government regulation; however, when the structure of the market tends towards becoming an oligopoly, self-regulations borders very dangerously with self-protective cartels.

* * *

However, one further point that needs to be addressed as a prerequisite to prudential supervision is the role of information/disclosure and the trustworthiness of information/disclosure in the financial market.

The sudden crisis of many financial intermediaries showed that their accounts were not properly drafted because they did not show, or they falsely showed, the risks they were taking.

When this happens, the diagnosis can only be that accounting regulations evidently have gaps or loopholes: either accounting techniques were not proper, or control on the truthfulness of accounts was not proper.

Accounting standards should envisage a set of rules providing for a complete representation of the management of the firm, accounting for all risks incurred, even those that may be quiescent (*e.g.* lending of guarantees, derivative instruments). Generally, these are dealt as off-balance sheet issues, their actual risk should be accounted on-balance. In any case, evaluations of items in the balance sheet should not be based upon the assumption (contrary to traditional accounting doctrines) that markets will always go upwards.

Fair value accounting should not be taken to an extreme, also in view of its extreme volatility. It is worth to recall that, under European company laws, accounting serves not only information purposes (and in that respect IAS/IFRS probably failed by giving an appearance of wealth, tied to contingencies), but also organizational purposes in determining available capital and distributable earnings and losses (in which respect, the representation of the company as a going concern does require greater attention to historical cost, rather than to mark-to-market accounting).

Moreover, greater attention should be drawn towards the position of those who control company accounts. In this respect, even before credit rating agencies and investment bankers, auditors, who verify company information at the very source, play a central role.

Measures to be adopted with regard to auditors should aim at:

i) greater pluralism in the market, breaking the current oligopolistic structure, thus enhancing its competitiveness;

ii) independence (which probably requires for auditors to specialize in exclusive activity);

iii) effectiveness of accountability (civil liability, adequate penalties);

iv) proper system of qualification and supervision (also at an international level).

* * *

All the above considerations concern the contingent situation as it emerged from the financial crisis. Let me try and make some final and concluding remarks having a broader view at the structure of the financial market in Europe: how financial resources and savings go from households to firms and businesses.

Traditionally, financial resources have been channeled towards business through the banking system (for historical reasons, tax measures, general economic policy, state ownership of banks).

The EU regulatory system of the financial market (through the banking and financial directives) has confirmed this structure, implementing the German model of the "universal bank".

Banks carry out the "banking business" (collection of reimbursable funds and granting of credit), but they may also carry out investment services (broker-dealer, underwriting, placement, asset management) and hold shares in commercial firms.

As a consequence, the commercial firms needing finance continue to have banks as their single interface: the various forms of finance (risk and credit capital, access to savings through direct collection – issuing shares or debentures – or through typical bank lending contracts) are components of a whole complex service offered by the banks, either directly or through their group organization. Indeed, notwithstanding that investment services activities are not reserved to banks or banking groups, there is no doubt that credit institutions

do have a competitive advantage *vìs-a-vìs* non banking independent intermediaries. The greater attractiveness of banks is founded upon the alleged synergies among financial activities they may develop. In the regulatory framework, when the universal bank model was accepted and implemented, these synergies were deemed superior to any possible jeopardy to stability arising from despecialization of banking. The bank is then the "supermarket" of finance: commercial firms will resort to banks to obtain and realize the fair mix of their financial structure.

This means that commercial firms do not benefit from any competition between direct access to savings and intermediated access to savings. In the financial market competition will then operate merely on the "subjective" profile (Bank A competes with Bank B), and not on the functional profile (commercial firm will resort to the financial channel X, rather than to the financial channel Y, based upon their best convenience).

The described structure of the financial market raises the question as to whether the efficiency of the market may be jeopardized by the absence (or, better, the softening) of a competitive factor such as the possibility to substitute financial channels according to competitive criteria. Indeed, it may be argued that the lack of functional competitiveness (between banking credit and direct access to the public markets) may be set off by a high degree of "subjective" competitiveness (between the various banks operating on the market): this high level of competitiveness is quite difficult to obtain, physiologically, in the banking industry, because of the very relevant public interest involved (in particular, for the monetary concerns) and consequently for the high degree of government administration of the sector, even with regard to the market for corporate control in the industry.

Many concerns arise from this situation:

i) the possible crisis of the banking institution is perceived as the crisis of the financial circuit through which finance is provided to the firms, making it difficult for the commercial firm to find a suitable substitute for its financing source;

ii) the centrality of the bank within the overall economic and financial system envisages the risk that public supervision over banks may cross the border and approach some form of supervision over the industrial and commercial firms, especially the largest firms. This risk rises further considering the high level of concentration of the banking industry (concentration which in many cases was pursued and facilitated by the supervisors, to allow banks to reach an alleged competitive dimension in the European and global market);

iii) conflicts of interests are intrinsic in such structure. Conflicts within the various investment services and securities activities exercised by the bank (*e.g.* underwriting/placement and asset management; investment advice and asset management *etc.*), but also conflicts between the typical banking activity and the securities activities: *e.g.* the case of the bank placing on the market debentures issued by the commercial firm, the proceeds of which will be used to reimburse the bank for a loan made to the firm itself.

The latter issue, conflicts of interest, does raise very serious concerns. Traditionally legislators have dealt with conflicts of interests within the securities business. The principles developed therein may indeed supply guidance to discipline conflicts of interests arising across the financial industry, when carrying out banking business as well.

However, we may notice that, over the past few years, there has been reduced and softer regulatory attention to conflicts of interests issues. The MIFID directive, for example, states that "*an investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest* [...] *from adversely affecting the interests of its clients*". Thus, the conflict of interests becomes a physiological item in the carrying out of activity by the intermediaries and they, themselves, are entrusted with the management and solution of the conflict. Indeed, traditionally the only regulatory walls between banking firms and commercial firms have been set out as

restrictions for banks to hold stakes in commercial firms and for commercial firms to hold stakes in banks: such restrictions, in the last few years, are becoming softer and softer.

What solutions may be offered? Certainly one might think it is anachronistic to suggest to go back to a rigid specialization of the financial services, especially now that not even the United States may be considered as an example in that respect, after the repeal of the Glass Steagall Act. However, a much clearer implementation of legal devices that better favor the functioning of market mechanisms even in the financial industry should be endorsed: *i)* the action for damages, and *ii)* the transparent disclosure of the insolvency and crisis situation for financial firms. An easier pursuit of the action for damages would ensure protection to the investors and, obviously, would lead businesses towards models of organization and activities that may better respond to market forces; whereas the transparent disclosure of the crisis (rather than the concealed administration of crises so far managed by public authorities) would allow a better accountability and responsibility, more precisely distributing duties and rights. Indeed, it is useful to recall that prudential supervision should be there to avoid systemic crises, to avoid that the crisis of one single institution may spread to other institutions, it is not there to avoid altogether crises of any institution! In this respect it is worth remembering that the efficiency of a system, better, whether a system responds to market mechanisms may be evaluated, among other things, not only by the possibility for new actors to enter the industry, lowering and eliminating any barriers to entry, but also by the inexistence of barriers to exit the market, protecting the "freedom to go bankrupt".

Again, in order to pursue these objectives (the effective operation of the damages remedy and the freedom to fail), accounting and auditing remain fundamental elements: if disclosure and available information cannot be trusted or relied upon, then any legal mechanism which tries to enforce and favor market forces will be useless or, in some cases, even counterproductive.

The Recent Introduction of Crisis Taxes in Hungary

Daniel Deak
Budapesti Corvinus Egyetem

Thank you very much for the possibility to say a few words and to share some information with you on the Hungarian reaction to this financial crisis.

It was indeed both important and necessary for a country like Hungary to react to this crisis.

Firstly because, as discussed already yesterday, the crisis had a particularly bad impact on the emerging markets (including a country like Hungary).

Secondly because Hungary was in a special situation, even compared to the other emerging markets, because of the high level of public debt, (so the country was in a special situation) and there were no resources to mobilize in order to manage the crisis.

So this is why, as experienced already yesterday, Hungary and Poland are in very different situations, because the general Polish financial conditions were not as bad and detrimental as the case was in Hungary.

So it was unavoidable, inevitable and necessary to introduce special fiscal measures. Special economic measures, including fiscal measures.

The first piece of measures in series was to introduce the bank tax. This is a tax that applies to the turnover, to the sale receipts. Although the rates seem to be at a glance small and low, it is a huge amount to be collected in terms of taxes. It is also a special feature of

this Hungarian bank tax that the credit institutions are invited to pay a 20 per cent profit tax and then they are allowed to reduce the sales related tax liability by the profit tax paid. There is also the rule that the profit tax must be paid up to the amount of the possible sales related tax. So, simply speaking, the first step is to pay profit tax and, if the opportunity of the profit tax is exhausted, then the next step is to pay the sales related tax.

There are other areas as well where special taxes have been introduced: retail trade, telecom and energy supply. Again, you can find about the tax rates that are applied to the sales of these companies that are active in the respective sectors. Again, it is a quite huge burden of tax. These are special taxes, which it means that they will be faced out – as promised by the law – on January 1, 2013.

The volume of these taxes is quite significant. Just to give an example for that two, in 2010 the government expects to derive 361 billions HUF as tax revenue from these taxes, which is more than half of the all revenue that can be collected from the enterprises. This is clearly a significant burden for companies.

And now let me say just a few aspects of the possible assessment of these taxes. The first question is the principle of discrimination, whether there is a problem of non-discrimination in that cases because, you know, if the taxes applied to banks, to energy suppliers and to telecom companies, what can argue of course foreign hold companies is discrimination against foreigners but probably there is no sound legal basis for this argument because the tax is levied not according to the legal form of the ownership of these enterprises, but the tax is levied on the sales as made within the territory of Hungary. So, from a legal perspective, it is hardly possible to refer to non discrimination principle.

Other issue is the problem of over-taxation. Over-taxation is a constant problem in Hungary. More than half of the gross domestic product is re-distributed through fiscal channels. There is very small trust in public institutions. In such circumstances, if new taxes are introduced of course it is not welcome. Even one can

argue that such a fiscal policy may operate to the detriment of market economy. It can paralyse the formation of capital. So the introduction of such domestic taxes may be harmful to the formation of capital and it can really be a challenge for the economy. I refer to a famous paper written in the twenties of the last century by Joseph A. Schumpeter. He tries to explain the very close relationship between the taxing State and the economic potential, the potential of the market economy, so the tax system must not operate to the detriment of the formation of capital and I'm afraid that we are very close to this problem in Hungary.

Well, we will see in the future if the Hungarian policy will be successful. There is very clear indication of the fact whether the country will be successful or not, just we have to check the financial market, at what rate the Hungarian debt will be subscribed. If these rates will not be too high, than the country will be successful. But is just the future that will tell us the answer.

Second problem that I would like to highlight: it is the problem of legal certainty. This is a special tax, you know, it has been introduced for particular years and for particular reasons. This means that it may destabilize the legal basis of taxation. It is a kind of tribute, I would like to argue. The tribute, you know, the difference between the tribute and the tax is that if you have to pay tax there is a legal basis for that, even before the start of economic activity, but this is not the case so it is difficult to justify such a type of tax because it is indeed a challenge to the legality of the tax system. It is difficult to defend such a special tax unless there is a link between taxation on the one hand and the provision of certain services in the same industry on the other hand. So that can be a kind of systemic tax as already was mentioned that could be a link between the liability to pay tax and the provision of public services. But this is not the case in Hungary because of cross-financings so, if you asked me what about how the revenue that is collected from these taxes will be used by the government, well the answer is for the general purposes of the budget. So the revenue that is collected from these

areas will not be reintegrated in the same industries, in the same areas. This is the reason why Hungary has to face an infringement procedure that will be initiated by the EU. Infringement procedures will be started against France and Spain also because of the problem of this cross-financing. You know there are certain sectors like the telecom sector where there is a very close system of checks and balances and a tax that is newly introduced may hamper this balance. So, this is why it is prohibited to make such an interference with this system.

The final problem I would like to highlight is the problem of neutrality. Such taxes are cascade taxes, different from VAT of course. So, this means that if there is a long chain of transactions for example then the tax burden will be accumulated. So it is really a challenge to the neutrality principle that this tax is to hamper the economic logic of transactions. Also it is a problem for the purposes of creating transparency in transactions.

So, what about the arguments you could use if you would like to defend the rationale behind these taxes? First you could highlight that there is windfall profit that comes from this crisis and windfall profit may be taxed. Secondly, you can refer to the crisis. It is not just about special taxes we are discussing but these are crisis taxes: in special circumstances it is an opportunity also for the State budget to have resort to special measures. Then you can argue as well that these taxes are Robin Hood taxes, so the State is like Robin Hood to rob the rich but to save the poor. Even you can refer to certain European initiatives as already discussed or mentioned or touched upon: the financial transaction tax or the financial activity tax that you can find in a working paper of the European commission.

My final word would be that maybe in certain circumstances you can justify the application of such a special tax but in that case the tax would not be simply a tax but I would like to say a para-fiscal charge so there should be a link between the liability to pay tax and the provision of public services. And if this link can be explored than

you can defend why you have introduced a new kind of tax. But I am afraid that the Hungarian special taxes failed to meet even this requirement so I'm quite critical and sceptical about these Hungarian taxes.

The Polish Approach Towards Post-Crisis Bank Levies and in the Field of Taxation in General

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1. Introduction

The case of Poland is very specific in comparison to other countries of the EU. While almost all EU Member States had to face decreasing GDP combined with financial and budgetary crises, in 2009 Poland was the only EU country with increasing GDP[1]. Polish state was also not forced to bail out financial institutions. On the other hand, in recent years budgetary results of Poland worsened and therefore some reaction was required. Still, the steps taken by the government were moderate in comparison to other EU Member States.

2. Direct taxation

The first trend that could be observed in recent years in Poland was a gradual shift from direct to indirect taxation, although account

[1] According to Eurostat data, in 2009 Polish GDP grew by 1.6 percent: *http://epp.eurostat.ec.europa.eu/tgm/graph.do?tab=graph&plugin=1&pcode=tsieb020&language=en&toolbox=data*

taken of circumstances in which decisions leading to such effect were made, this very shift should not be associated exclusively with recent economic and financial crisis. Since the initial reduction of burden in direct taxation driven by good condition of the budget before the crisis for political reason could not be reversed, the government had to pursue tax revenues from different sources, i.e. indirect taxes.

The first step as regards direct taxation was taken in the field of personal income taxation (PIT). Polish system of PIT traditionally envisages progressive taxation on labor income. Since January 1 2009, two tax brackets[2] instead of three[3] have been introduced[4]. This decision, taken in the peak of economic growth of the country, led to significant drop in budgetary revenues from personal income tax in years when global economy was struck by the financial crisis. It resulted in smaller tax burden especially on labor. Individual entrepreneurs already had an option to choose between progressive taxation and flat rate of 19 per cent, so the amendment concerning rates has not been so significant to them. No other changes that would have had important impact on budgetary revenues from PIT were introduced. Unlike other EU countries, Poland has not increased taxation on bonuses and stock options plans. Actually, on the contrary, stock option plans enjoy preferential tax regime as they are taxed upon realization of profits from acquired shares. Income derived from this source is considered capital gain and taxed with flat rate of 19 per cent. However, some steps have been taken to protect Polish tax base,

[2] 18 per cent (applicable to income up to 85.528 PLN – approximately 21.400 EUR) and 32 per cent (applicable to income exceeding this amount).

[3] 19 per cent (applicable to income up to 44.490 PLN – approximately 11.120 EUR), 30 per cent applicable to income between 44.490 PLN and 85.528 PLN), 40 per cent (applicable to income exceeding 85.528 PLN).

[4] By virtue of *ustawa z dnia 16 listopada 2006 r. o zmianie ustawy o podatku dochodowym od osób fizycznych oraz o zmianie niektórych innych ustaw* (*Act of 16 November 2006 amending Act on Personal Income Tax and Some Other Acts*) Dziennik Ustaw Nr 217, poz. 1588 (Journal of Laws No. 217, item1588).

but they refer more to business taxation and will be discussed together with changes in corporate taxation.

Table 1. Budgetary revenues from personal income tax in years 2007-2010 (amounts in thousands of PLN/EUR)[5]

2007	2008	2009	2010
60.959.164 PLN (15.240.000 EUR)	67.193.526 PLN (16.800.000 EUR)	62.740.785 PLN (15.685.000 EUR)	62.487.000 PLN (15.622.000 EUR)

Poland offers one of the lowest levels of corporate income taxation in the EU as the statutory rate of CIT equals to 19 per cent. This is supposed to draw investments and lead to an increase in budgetary revenues from CIT, even in crisis, especially with a view to the fact that Polish GDP has been constantly growing over the past years. However, what has been observed recently was a constant erosion of CIT base. There were several reasons for such a trend. First of all, Poland grants significant tax incentives in special economic zones as regional investment and employment aid.

[5] Amounts from *Wpływy budżetowe w okresie od 1 stycznia 2007 r. do 31 grudnia 2007 r. (dane łączne uzyskane z izb celnych i izb skarbowych)* (*Budgetary Revenues in Period from January 1, 2007 to December 31, 2007 (Consolidated Data Acquired from Customs and Tax Authorities*), *Wpływy budżetowe w okresie od 1 stycznia 2008 r. do 31 grudnia 2008 r. (dane łączne uzyskane z izb celnych i izb skarbowych)* (*Budgetary Revenues in Period from January 1, 2008 to December 31, 2008 (Consolidated Data Acquired from Customs and Tax Authorities*), *Wpływy budżetowe w okresie od 1 stycznia 2009 r. do 31 grudnia 2009 r. (dane łączne uzyskane z izb celnych i izb skarbowych)* (*Budgetary Revenues in Period from January 1, 2009 to December 31, 2009 (Consolidated Data Acquired from Customs and Tax Authorities*), *Wpływy budżetowe w okresie od 1 stycznia 2010 r. do 31 grudnia 2010 r. (dane łączne uzyskane z izb celnych i izb skarbowych)* (*Budgetary Revenues in Period from January 1, 2010 to December 31, 2010 (Consolidated Data Acquired from Customs and Tax Authorities*). Available at *http://www.mf.gov.pl/dokument.php?const=3&dzial=149&id=48490&typ=news*, August 29, 2011.

Secondly, Polish tax legislation has offered some opportunities for reasonably easy to implement tax avoidance solutions. They result mainly from some favorable provisions of double taxation conventions concluded by Poland, i.e. with Cyprus, which includes tax sparing clause in respect of dividends, interest and royalties. These provisions, combined with national legislation, allow for a wide range of structures to avoid taxation, of which tax authorities are fully aware. Thirdly, Polish tax legislation contained also some loopholes. For example, until 2011 Polish acts on PIT and CIT allowed step ups with regards of intangibles generated in transparent entities when the legal form of the entity was subject to change into legal person or as a result of transfer of branch of activity into an entity with legal personality. It was possible to disclose value of such intangibles in the accounts of newly created entity on market level and further depreciate it.

Table 2. Budgetary revenues from corporate income tax in years 2007-2010 (amounts in thousands of PLN/EUR)[6]

2007	2008	2009	2010
32.165.456 PLN (8.042.000 EUR)	34.635.014 PLN (8.659.000 EUR)	30.744.318 PLN (7.686.000 EUR)	27.891.932 PLN (6.973.000 EUR)

Consequently, Poland introduced some measures as a reaction to the erosion of its tax base. First of all, renegotiations with respect of DTC with Singapore, Malaysia and Cyprus concerning tax sparing clauses have been started. Polish Ministry of Finance announced also that it will attempt to renegotiate DTC with Luxembourg according to which Poland does not tax dividends received from Luxembourg by Polish residents[7]. Poland has also already finalized

[6] See: footnote 5.

[7] Article 24.1.a) and b) of *Konwencja między Rzecząpospolita Polską a Wielkim Księstwem Luksemburga w sprawie unikania podwójnego*

renegotiations of the DTC with Malta[8] and Czech Republic[9] that resulted in removing tax sparing clauses from these Conventions. Moreover, significant amendments in national tax legislation were made. The opportunity for step ups has come to an end since January 2011[10]. Also tax authorities started to be more strict in the application of tax regulations which was especially noticeable in very conservative and pro-fiscal approach expressed in issued advanced rulings. This lead to an increasing amount of litigations before administrative courts in progress. Tax authorities became also more active in the field of tax audits. Although the number of audits dropped in comparison to previous years, the amount of tax arrears disclosed equaled to an average of 290.000 PLN (approximately 72.500 EUR)[11].

opodatkowania w zakresie podatków od dochodu i majątku, sporządzona w Luksemburgu dnia 14 czerwca 1995 r. (*Convention between the Republic of Poland and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, signed in Luxembourg on June 14, 1995*).

[8] *Protocol of April 6, 2011 between the Government of the Republic of Poland and the Government of Malta amending the Agreement between the Government of the Republic of Poland and the Government of Malta for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes in Income, signed at Valetta on January 7, 1994.*

[9] *Agreement between the Republic of Poland and te Czec Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed on September 13, 2011.

[10] By virtue of *ustawa z dnia 25 listopada 2010 r. o zmianie ustawy o podatku dochodowym od osób fizycznych, ustawy o podatku dochodowym od osób prawnych oraz ustawy o zryczałtowanym podatku dochodowym od niektórych przychodów osiąganych przez osoby fizyczne (Act of November 25, 2010 amending Act on Personal Income Tax, Act on Corporate Income Tax and Act on Lump Tax on Some Revenues Derived by Natural Persons)*, Dziennik Ustaw Nr 226, poz. 1478 (Journal of Laws No. 226, item 1478).

[11] Ministry of Finance – Department of Tax Audit, *Tasks of Tax Audit Offices for 2011 (abbreviated version)*, available at: *http://www.mf.gov.pl/_files_/ks/wyciag_zadan2011.pdf*, August 31, 2011.

3. Budgetary condition

Polish Constitution[12] in Chapter X "Public Finance" contains *inter alia* provisions on budgetary expenditures. Article 216 of the Constitution sets the ceiling for the proportion between the national public debt and the value of the annual GDP. According to this provision, national public debt shall never exceed three-fifths of the value of the annual gross domestic product. The specified cautious and restructuring procedures aimed at bringing this proportion to respective balance are provided in the Act of August 27, 2009 on Public Finance[13].The Act on Public Finance contains provisions concerning special procedures that are enacted when the proportion between public debt and the value of annual GDP reaches certain levels. When public debt equals to 50 per cent of GDP but is smaller than 55 per cent of GDP, budgetary deficit in draft budgetary act for the following year cannot be higher than deficit from budgetary act for the present year. If the proportion between public debt and GDP exceeds 55 per cent, draft budgetary act for the following year cannot envisage any deficit, remunerations of employees of the governmental sector cannot be raised, no new loans and credits from budgetary sources can be granted and valorization of pensions is restricted to certain extent.

4. Indirect taxation

As public debt in Poland in 2010 equaled to 52,8 per cent of GDP[14], some steps needed to be taken. This led to the decision to

[12] *Constitution of the Republic of Poland of 2 April 1997*, Dziennik Ustaw Nr 78, poz. 483 ze zm. (Journal of Laws No. 78, item 483, as amended).

[13] *Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych*, Dziennik Ustaw Nr 157, poz. 1240 ze zm. (Journal of Laws No. 157, item 1240 as amended).

[14] According to the Ministry of Finance statistical methods for counting debt. Ministry of Finance, *2010. Public Deb in Poland. Annual Report*. Available at:

raise the rates of goods and services tax (Polish VAT), as the Ministry of Finance observed growing revenues from this tax and considered it the most effective way to collect additional sources. Therefore, the regular VAT rate has been raised from 22 per cent to 23 per cent (the other two rates have been raised from 7 per cent to 8 per cent and from 3 per cent to 5 per cent) for the period between January 1, 2011 and December 31, 2013[15].

Table 3. Budgetary revenues from goods and services tax (VAT) in years 2007-2010 (amounts in thousands of PLN/EUR)[16]

2007	2008	2009	2010
96.349.847 PLN (24.088.000 EUR)	101.782.739 PLN (25.446.000 EUR)	99.454.721 PLN (24.864.000 EUR)	107.879.702 PLN (26.970.000 EUR)

Moreover, if public debt on December 31, 2011 and at the end of following years exceeds 55 per cent of GDP, the rates will be raised gradually up to 25 per cent, 10 per cent and 7 per cent[17].

5. Taxation of financial institutions

Although banks in Poland did not require any State support, two aid schemes as regards financial institutions were introduced and

http://www.mf.gov.pl/_files_/dlug_publiczny/obligacje_hurtowe/raporty_roczne/raport_roczny_2010.pdf.

[15] *Ustawa z dnia 26 listopada 2010 o zmianie niektórych ustaw związanych z realizacją ustawy budżetowej* (*Act of 26 November 2010 amending Some Acts Connected with the Realization of the Budgetary Act*), Dziennik Ustaw Nr 238, poz. 1578 ze zm. (Journal of Laws No. 238, item 238 as amended.

[16] See: footnote 5.

[17] Article 9 of *Ustawa z dnia 16 grudnia 2010 r. o zmianie ustawy o finansach publicznych oraz niektórych innych ustaw* (*Act of December 16, 2010 amending Act on Public Finance and Some Other Acts*), Dziennik Ustaw Nr 257, poz. 1726 (Journal of Laws No. 257, item 1726).

accepted by the European Commission, i.e. bank guarantee scheme[18] and bank recapitalization scheme[19]. State aid allowed under these schemes has not been granted so far. On the other hand, Poland planned to introduce financial stability contribution which would be imposed on the value of assets decreased by the value of deposits and tier-1 capital. The rate of the contribution has not been revealed so far. Revenues from such contribution would be gathered in separate stability fund in Bank Guarantee Fund (Polish deposit guarantee scheme) and used to finance of resolution of banks. Recently, due to the proposal to introduce Financial Transaction Tax on EU level, works on this instrument have been abandoned. Poland has not taken definitive approach towards the proposal of FTT Directive.

6. Proposals of solutions on EU level

On March 16, 2011 the Commission published Proposal for a Council Directive on a Common Consolidated Corporate Tax Base[20]. Polish Ministry of Finance took negative approach towards this project. First of all, Poland is against harmonization of direct taxation, especially as regards rates. Although no harmonization concerning rates is proposed by the Commission, Poland perceives this proposal as the first step to the harmonization of this element. Additionally, it is unacceptable from the budgetary perspective that the tax base will be distributed only once a year while currently income tax withholdings are paid every month.

Poland took a negative approach also towards Proposal for a Council Directive amending Directive 2003/96/EC restructuring

[18] European Commission's decisions in cases: N 208/2009, N 658/2009, N 236/2010, N 533/2010, SA.33008 and SA.32946.

[19] European Commission's decisions in cases: N 302/2009, N 262/2010, N 534/2010 and SA.33007.

[20] Brussels, COM(2011) 121/4.

the Community framework for the taxation of energy products and electricity published on April 13, 2011[21]. There are no plans on national level to introduce any CO_2 taxation and while coal is still most commonly used for energy and heat production, Polish industry will still have to bear the burden of the "Climate Package" and pay costs for emission allowances under EU Emission Trading System. Another fiscal burden would additionally hinder competitiveness of Polish enterprises in comparison to entities from other EU countries where renewable energy sources are already much better developed.

7. Conclusions

Steps taken by Polish government have not been planned as a coherent reaction to the financial and budgetary crisis. They were more a response to particular immediate needs, i.e. as regards budgetary revenues. However, some trends can be distinguished in changes made in domestic tax legislation. First of all, in personal income taxation, lower burden has been put on labor income, while taxation of business income has remained without significant amendments. No incentives have been introduced to foster particular behaviors in this field. Secondly, changes in corporate income taxation aimed at protection of tax base, which should not be associated exclusively with financial crisis, but more with progressing erosion of Polish corporate tax base. Thirdly, increase in VAT rates has been introduced to improve budgetary condition. Fourthly, as financial institutions in Poland did not require State aid, they are not held responsible for poor budgetary results. Therefore, no taxes on financial institution, revenues from which would go straight to the budget, have been proposed. On EU level Poland takes a position against further harmonization of

[21] Brussels, COM(2011) 169/3.

direct taxation and while Polish industry will bear high burden of the "Climate Package" is also against introduction of obligatory environmental taxes.

Waiving Bank Secrecy and Exchanging Tax Information in Cross-Border Situations: The Austrian Way to Global Fiscal Transparency

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1. Introduction

Although the protection of confidentiality is generally recognised of particular importance in Austria, it was not until 1979 that specific rules were issued on banking secrecy. The main reason for issuing such rules, first contained in Section 23 of the 1979 Austrian Credit Law (*Kreditwesengesetz* – KWG)[2], was to set some clear cut obligations on banking institutions concerning the

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[2] BGBl 1979/63. This law replaced the German law on credit, applicable in Austria since 1 October 1938 as a consequence of the annexation to the German Third Empire. A possible model for Section 23 KWG was provided by Section 22.3 of the Post Office Banks Law (*Postsparkassengesetz*).

handling of confidential information concerning the clients and their accounts.[3] The protection was further strengthened in 1988, when the rules on banking secrecy were made the object of the so-called block of constitutionality, subordinating their amendment to an approval by a two-third majority in the Parliamentary Assembly (*Nationalrat*)[4].

This chapter aims at analysing the features of Austrian rules on banking secrecy and at highlighting the dramatic change that Austria has experienced since 2009 as a consequence of the global evolution towards fiscal transparency that took place under the auspices of the Global Forum on Fiscal Transparency. In particular, such evolution took Austria to waive banking secrecy in cross-border situations for tax purposes, while preserving it in purely internal situations.[5]

2. The legal dimension of banking secrecy and its consequences under Austrian tax law

The legal dimension of banking secrecy in Austrian domestic law is essentially determined by Section 38 of the Austrian Banking Law (*Bankwesengesetz* – hereinafter: BWG)[6], which replaced the previously applicable rules in connection with the accession of Austria to the European Union in order to provide for a regulation fully consistent with the obligations stemming from the supremacy of supranational law. Among other, in such occasion Austria abolished the

[3] Before 1979 the bank secrecy was a part of the contractual basis between the client and the bank, whereas the duty to discretion was a civil law secondary duty. See Doralt, *Das Bankgeheimnis im Abgabeverfahren* (1982) p. 11.

[4] BGBl 1988/415.

[5] See STARINGER/GÜNTHER, *Bankgeheimnis und Internationale Amtshilfe in Steuersachen*, in Lang/Schuch/Staringer (eds.) Internationale Amtshilfe in Steuersachen (2011) pp. 207 et seq.

[6] BGBl 1993/532.

anonymity of savings accounts[7], though making the access to the accounts always subject to a specific judicial authorization.

According to Section 38 BWG, credit institutions, their shareholders, members of their organs, employees and all persons otherwise acting for them may not disclose or dispose of secrets, which were accessible to them exclusively on the basis of their business relations with the client. The obligation to preserve secrecy is of unlimited duration and aims at providing a strong and lasting protection of the confidentiality of banking information against external disclosures.

A specific definition of bank secrecy is not included in Section 38 BWG. However, secret is generally understood to require a full confidentiality of the credit institution in the interest of the clients in respect of any non-publicly available information arising from the business relation between the credit institution and its clients. For such reason the secrecy is not confined to the sole information concerning the client, but is also understood to include any additional person directly involved in the business relationship between the bank and its client[8].

Literature generally acknowledges the existence of a right of the client to determine the boundaries of confidential information, which is binding on the credit institutions. However, the Austrian High Court (*Oberste Gerichtshof* – OGH) has reconciled such subjective delimitation of banking secrecy with a more general and objective dimension of secret in the client's interest[9], which may be waived in the presence of a specific request by the client[10].

[7] This was also recorded by the OECD, 2003 Progress Report on the Access to Bank Information, p. 6.

[8] Since the protection of such persons is a mere consequence of the secrecy concerning the business relationship between the bank and its client, it may fall to the extent that the client gives his consent to waive the secret. See JABORNEGG/STRASSER/FLORETTA, *Das Bankgeheimnis* (1985) p. 84.

[9] OGH 25.2.1992, 4 Ob 114/91; see also JABORNEGG/STRASSER/FLORETTA, *Das Bankgeheimnis*, p. 17.

[10] Literature generally believes that such authorization may be revoked by

The obligation to full confidentiality stemming from the business relation between the bank[11] and its client covers all and every single activity carried out in the interest of the client and admits the exceptions listed in Section 38.2 BWG[12], which allows waiving of banking secrecy in the following nine groups of cases: First, banking secrecy can be waived towards criminal courts in connection with criminal procedures in the presence of a judicial request and in case of deliberate fiscal violations, exception being made for financial misdemeanours. The criminal procedure needs not necessarily to be an Austrian one. However, in case of a foreign criminal procedure, the waiver of the banking secrecy is only applicable to the extent that the standards of such procedure are in fact equivalent with the ones applicable under Austrian law[13]. This can create particular problems in case the investigation does not protect the basic rights of taxpayers to defence and appeal in the framework of tax procedures, especially as to the access to bank information. Second, there is no protection of banking secrecy in the presence of an obligation to disclosure set by Austrian domestic law on anti-money laundering, auditing, deposit guarantees and investor compensation. Third, in case of death of the client banking secrecy may not be opposed to the competent court and commissioner. Fourth, when the client is minor or other subject to tutelage on the basis of the law, the guardian or court is entitled to obtain information concerning the relation of the client with the credit institution. Fifth, the client may expressly give his consent in writing to waive the secret covering his relations with the bank. Sixth, generally worded information concerning the economic situation of an undertaking is not covered by banking secrecy to the extent that corresponds to the standard banking practice, unless when the undertaking explicitly objects it. Seventh, the bank is not bound by secrecy when acting to solve legal issues concerning its relation with the client. Eighth, banking secrecy does not cover the reporting obligations of the credit institutions set by the inheritance and gift tax act. Finally, ninth, insofar as the bank is obliged to report to the Austrian Authority for Securities (FMA)[14] in compliance with the provisions on supervision of securities and the stock exchange.

the client at any time with prospective effects. See on this JABORNEGG/STRASSER/FLORETTA, *Das Bankgeheimnis*, p. 103.

[11] All credit institutions regulated by Austrian law have to comply with such obligations, thus also binding foreign branches of Austrian banks insofar as Austrian law applies to their contractual obligations.

[12] See JABORNEGG/STRASSER/FLORETTA, *Das Bankgeheimnis*, pp. 44-47.

[13] See on this VwGH 26.7.2006, 2004/14/0022.

Despite the wording of Sec. 38.2 BWG one may suggest the list to be exhaustive. Courts have come to interpret it as merely illustrative list of cases that are definitely to be regarded as exceptions to the banking secrecy[15], thus opening the possibility to add further cases.[16] This interpretation was particularly important to understand how the development on banking secrecy could find a legal path, which allowed Austria to comply with the developments in the international standards of fiscal transparency without altering the block of constitutionality that protects banking secrecy.

In particular, under Section 38.5 BWG any alteration or amendment to Section 38.1 to 38.4 BWG must be approved by the Parliamentary Assembly in the presence of at least half of the total number of members of the Parliamentary Assembly and with a majority of two thirds of the votes.[17] This particularly strong protection is

[14] The Austrian Authority for Securities (*Finanzmarktaufsichtsbehörde* – FMA) in its current status is an independent body established in 2002 with a view to supervising the operative compliance of the banking sector with the legal framework in force.

[15] VwGH 28.10.1994, 94/17/0297.

[16] See Erläut zur RV 844 BlgNR, XIV. GP, 50; VwGH 28. 10. 1994, 94/17/0297; Laurer in Fremuth/Laurer/Pötzelberger, *KWG* Sec. 23 KWG MN 14 et seq.; JABORNEGG/STRASSER/FLORETTA, *Das Bankgeheimnis*, pp. 93 et seq.; AVANCINI/IRO/KOZIOL, *Bankvertragsrecht*[2] I MN 2/63; SEIDL, *Das Bankgeheimnis*, in Hofinger/Brandner (eds.) Aspekte des Kreditwesengesetzes nach der Novelle 1986 (1987) pp. 257 et seq., pp. 264 et seq.; ARNOLD, *Das Bankgeheimnis im Strafverfahren nach der KWG-Novelle 1986*, *ÖBA* 1988, p. 989.

[17] Critical JABORNEGG, *Neues zum Bankgeheimnis (Teil 1)*, WBl 1990,

generally intended to secure the stability of the protection of banking secrecy, but covers in fact only Section 38.5 BWG. Nevertheless, by protecting Section 38.5 BWG, the system also protects the entire content of Sections 38.1 to 38.4 BWG, which may only be amended with the majority indicated in Section 38.5 BWG. However, since the list of exceptions contained in Section 38.2 BWG is not exhaustive[18], Austria could quickly adapt its legislative framework to the new international requirements on international mutual assistance between tax authorities, which are better known as global fiscal transparency.

The tax implications of such rules can be briefly analysed before focusing on the Austrian way to global transparency. In particular, Section 171.1.c of the Federal Tax Code (*Bundesabgabenordnung* – hereinafter: BAO) prohibits bank from answering questions when this implies a violation of a recognised obligation to keep confidentiality. This implies that from a tax perspective banks acting as witness or receiving requests for information are legally authorized under Austrian law to refrain from breaking the secrecy. Later in this paper, the consequences of this provision for the international context will be interpreted in the light of the 2009 rules on the implementation of mutual assistance (*Amtshilfedurchführungsgesetz* – hereinafter: ADG). However, one should not forget that, under Section 48a BAO, tax authorities are obliged to keep confidentiality of bank

pp. 29 et seq.; ARNOLD, *Bankgeheimnis: Ausländische verwaltungsbehördliche Finanzstrafverfahren am (qualifizierten) Prüfstand der Rechtstaatlichkeit – Zugleich eine Besprechung des VwGH Erk vom 26. 7. 2006, 2004/14/0022*, ÖBA 1988, p. 989.

[18] Theoretically the non-exhaustive nature of the list is rejected by a minority view in Austrian literature [(see SCHINNERER in Fuchs/Slaik/Schinnerer (eds.) *Aktuelle Probleme zum Recht des Kreditwesens – Festschrift für Hans Krasensky zum 75.* Geburtstag (1978) p. 176]. However, the author believes that the development in Austrian tax treaties signed after 13.3.2009 (see the details related to the introduction of the ADG under section 2) automatically prove that this minority view is irrelevant. If this were not the case, then all treaties would be deprived of their legal basis for not having been signed by the majority requested under the block of the constitutionality.

information in their possession as if it were a professional secret concerning their activity as civil servants[19].

3. The Austrian way to global fiscal transparency

The OECD was the true engine that catalysed a dramatic change in fiscal transparency and mutual assistance on tax matters over the past few years, in particular since 2008, when there were various international scandals (including the sale of stolen confidential information from Liechtenstein banks and the UBS case).[20] On 2 April 2009 the G20 agreed "to take action against non-cooperative jurisdictions including tax havens", adding that "the era of banking secrecy is over". In just a matter of a few months soft law forced Austria to make a u-turn in the foundations of its mutual assistance in tax matters at the international level, which Austria had refrained for several years. Accordingly, Austria removed on 13.3.2009 its 2005 reservation on Article 26.5 OECD Model Tax Convention, thus making it possible to exclude that banking secrecy could represent a valid justification to reject the exchange of information[21].

[19] See Art. 20.3 B-VG (Austrian Constitution); LANGHEINRICH/RYDA, *Das Verhältnis der abgabenrechtlichen Geheimhaltungsverpflichtung zu Amtsgeheimnis und Amtsverschwiegenheit (Teil 1)*, FJ 2010, pp. 9 et seq.; RITZ, *BAO*[3] Sec. 48a MN 1 et seq.; URTZ, *Das Steuergeheimnis als Schranke des grenzüberschreitenden Informationsaustausches zwischen Finanzbehörden*, Dissertation an der Universität Wien (2001) pp. 60 et seq.; HALLER, *Amtsverschwiegenheit, Amtshilfe und Akteneinsicht*, in Ruppe (ed.) Geheimnisschutz im Wirtschaftsleben (1980) pp. 143 et seq.

[20] See PISTONE/GRUBER, *Verweigerung des Informationsaustausches nach Art 26 OECD-MA*, in Lang/Schuch/Staringer (eds.) Internationale Amtshilfe in Steuersachen (2011) pp. 91 et seq.

[21] Under such clause Austria reserved the right not to include paragraph 5 (OECD MC) in its conventions. However, Austria was authorized to exchange information held by a bank or other financial institution where such information is requested within the framework of a criminal investigation which is carried on in the

According to the current OECD standards, all tax treaties (be them general or TIEAs) should allow for an effective exchange of information upon request to administration or enforcement of all tax matters even in the absence of a domestic tax interest. Although taxpayers' rights, including confidentiality, has to be preserved, exchange of information may not be rejected to tax authorities of the requesting state on the grounds that domestic law protects banking secrecy. However, based on the wording of para. 5 of the OECD Commentary on Article 26 an obligation to exchange information does not arise in the presence of fishing expeditions, i.e. requests for information that are not preceded by an appropriate preliminary instruction by the authorities of the requesting state[22].

This major revolution in mutual administrative assistance, which allowed the OECD to record a more significant progress between 2009 and 2011 than in the previous two decades: an unprecedented progress that quickly dismantled national opposition to flows of confidential information concerning bank accounts throughout the world, putting an enormous pressure on all jurisdictions that had protected it, including Austria.

The Austrian way to global fiscal transparency has some special technical features[23], which aim at reconciling the domestic pattern

requesting State concerning the commitment of tax fraud.

[22] See further on this in AUMAYR, *Der Umfang des Informationsaustausches*, in Lang/Schuch/Staringer (eds.) Internationale Amtshilfe in Steuersachen pp. 59 et seq; PISTONE/GRUBER, in Lang/Schuch/Staringer (eds.) Internationale Amtshilfe in Steuersachen, pp. 88 et seq.

[23] Alternative ways to global fiscal transparency have been followed by other countries concerned by the need to protect the confidentiality of information regarding the taxpayer, such as for instance Switzerland, which at present still does not include Article 26.5 OECD MC in its treaties, but applies a special wording of Article 26.3 OECD MC, which gives tax authorities powers to overcome banking secrecy in compliance with the current international standards. The Swiss way to global fiscal transparency is currently the object of amendment and statutory interpretation by the Swiss Parliament in order to overcome the difficulties arisen during the peer reviewing of the legislative framework, which ascertained a fairly rigid

with the international requirements and that are currently being made the object of peer reviewing by the mixed teams of the Global Fiscal Transparency[24]. In particular, as of 9 September 2009 the new rules on the implementation of mutual assistance (ADG)[25] entered into force, waiving banking secrecy in cross-border situations to the extent that this is required by a valid international legal basis, such as tax treaties or European Union law, while preserving it in the purely domestic ones in compliance with the need to keep unaltered the block of constitutionality under Section 38.5 BWG. By September 2009 Austria had also upgraded exchange of information in its treaties by reaching the level of twelve tax treaties that were needed in order to be removed from the OECD grey list[26].

The waiving of bank secrecy in cross-border situations does not automatically affect the situation of the client of an Austrian credit institution, since a procedure ensures an adequate protection from a request that is not founded or does not comply with the current internationally accepted standards. In particular, Austrian law ensures all persons entitled to the use of the bank account the rights of being promptly informed about the request and of filing (within two weeks from notice) a complaint against the supply of information, thus in fact ensuring them also the right of being heard and objection. Deferment are accepted only in exceptional cases. Under no

application of the concept of fishing interpretation, potentially harming the effectiveness of international mutual assistance.

[24] In particular, the first phase of the review of the Austrian system for exchanging information (concerning the existence of the legal framework) started in the first half of 2011 and the second phase (concerning its practical implementation and including an on-site visit by the peer-reviewing team) is expected to take place by the end of 2012.

[25] BGBl 102/2009.

[26] Eight Austrian general tax treaties (with Belgium, Denmark, Luxembourg, Mexico, Netherlands, Norway, San Marino, Switzerland, Singapore and the United Kingdom) and four TIEAs (Andorra, Gibraltar, Monaco and St. Vincent and the Grenadines) contained clauses on exchange of information at OECD standards by September 2009.

circumstances requests that in the view of Austrian tax authorities are well founded[27] may be forwarded to the requesting state before the said procedure has been completed with a positive result.

This procedure is a good compromise between the need to secure a swift and effective forwarding of information requested and the protection of taxpayers' rights, since the search for an enhanced protection of the Revenue interest may by no means turn into the opposite excess of sacrificing the basic rights of taxpayers. From this perspective the author also believes that the procedure can be regarded as a proportionate reaction that complies with the requirement of an effective fiscal supervision that is required by European Union law and that overcomes the friction that may otherwise arise for credit institutions as to the supply of confidential information. Furthermore, it also allows to ensure a protection of basic human rights[28]. Certainly, a review of the legitimacy of the supply of information by tax authorities of the requested state should not lead to delays and for this reason can only work to the extent that all relevant information is promptly processed. Although the ADG requires a prompt supply of information, no specific term is indicated by the law. Taking into account the need to quickly handle this information over and the availability of such data on electronic format, tax literature has indicated that two to three weeks should be appropriate for this purpose[29]. From

[27] Austrian tax authorities generally interpret the concept of fishing expeditions on the basis of a narrow concept of subsidiarity to gathering of information by the requesting State, considering that requests to the other contracting should only concern the information that may not be collected by the former state. See further on this in Jirousek, The Implementation of the OECD Standard on Transparency and Exchange of Information in Austria, *SWI* 2009, p. 493.

[28] The protection of human rights within the procedure for mutual administrative assistance aimed at exchanging tax information have been the object of considerable attention in Swiss case law. See BVG 15.7.2010, A-4013/2010 and TAF 11.10.2010, A-4935/2010. See further on this in PISTONE/KOFLER, *General Report*, in Kofler/Maduro/Pistone, Taxation and Human Rights in Europe and the World (2011) pp. 3 et seq.

[29] See FRABERGER/PETRITZ/EBERL, *Bankgeheimnis neu – ungeklärte Fragen (Teil 2)* RdW 2010, p. 62.

the same perspective, one may, however, wonder whether the right to file a complaint with the Austrian Supreme Administrative Court or the Austrian Constitutional Court, in principle available to the client, could to some extent increase this potential risk in order to ensure a more intensive protection of his rights related to banking secrecy. The same problem will also arise with the time-limits set by the new EU exchange of information directive.

4. Open issues and future perspectives

Austria has made a considerable progress on the way of fiscal transparency and there seem to be no valid reasons for denying that it complies with the international standards on cross-border situations. However, this conclusion does not imply that the Austrian way to global fiscal transparency and the waiving of banking secrecy is automatically immune from potentially critical situations.

Keeping banking secrecy in the purely internal situations is certainly a way to comply with the protection of fundamental values in Austria. However, one may wonder whether it may imply a difference in treatment that could generate a potential conflict with the principle of equality enshrined in Article 7 of the Austrian Constitution (*Bundesverfassungsgesetz*), but also with the non-discrimination principle under European Union law as to the different protection of confidentiality in purely internal and cross-border situations. From the latter perspective the author believes, however, that the right of EU nationals to enjoy national treatment, applicable under European Union law, cannot be invoked for the purpose of excluding the right of a Member State to obtain from Austria that information that is needed for the purpose of carrying out its own fiscal supervision. Although Austria is in principle allowed to reject the exchange of information within the European Union until the new Directive on exchange of information is transposed, the author believes it should refrain from doing so, taking into account its international

commitments to comply with the latest standards on fiscal transparency. This should apply on a more general basis in respect of all tax treaties whenever compatible with the actual wording of the exchange of information clause.

From the latter perspective the author, however, believes that a potential problem could arise with EU State Aids rules to the extent one succeeds in proving that banking secrecy give Austrian based undertakings a selective advantage if compared to the other undertakings.

However, in general terms, the procedures for waiving banking secrecy in cross-border situations are to be regarded as a model for reconciling fiscal transparency with an effective and immediate protection of taxpayers' rights to confidentiality, which should seriously be considered as best practice at the European level.