House of Lords European Union Committee: EU Economic and Financial Affairs and International Trade Sub-Committee: Towards a financial transaction tax

Response by the Wellcome Trust

November 2011

KEY POINTS

- We are concerned that the proposed financial transaction tax (FTT) would have a serious impact on charities with investment portfolios, including the Wellcome Trust, reducing the funding available to achieve our charitable objectives.
- As charities are not within the intended scope of a FTT, if the tax is introduced a mechanism must be found to relieve charities of the burden that it will impose.

INTRODUCTION

1. The European Commission is proposing to introduce a FTT, with the stated goal of ensuring that financial institutions make a fair contribution to covering the costs of the recent economic crisis. The Wellcome Trust takes no position on whether this is an appropriate policy objective. However, we are concerned that the proposal as framed would have a serious adverse impact on charities with investment portfolios, limiting their ability to advance their charitable missions.

2. The Wellcome Trust's mission is to achieve extraordinary improvements in human and animal health. We seek to advance this through a range of charitable activities including funding biomedical research and research in the medical humanities; supporting science education and public engagement with science; and fostering the application of research to improve health. We support these activities in the UK and internationally, with a growing proportion of our funding dedicated to supporting research in low-and-middle-income countries. In 2010 we committed a total of £678 million to our charitable activities.

3. According to the European Foundations Centre, the Wellcome Trust is the largest of the 55,000 European private independent charitable foundations, which have been endowed by generous philanthropists. These foundations collectively have investment assets of £160 billion (€ 175 billion); they directly employ over 500,000 people; they give away £45.5 billion (€ 50 billion) each year to benefit the public good.

4. A financial transaction tax would impact negatively on many UK charities that fund research. The UK is relatively unique internationally for the strength and importance of its medical research charity sector. In 2009-10, AMRC's 120 member charities spent over £1 billion on medical research in the UK – approximately one third of all public expenditure on medical research in the UK. Approximately half of AMRC member charities draw on investment income to sustain their charitable activities, alongside public donations and other sources of revenue.

5. The Wellcome Trust is unique among UK charities in that our charitable activities are entirely dependent on the income from our £14 billion investment portfolio, which is managed by an investment team with the aim of generating a 6 per cent real return over the long term. We are concerned that the imposition of a financial transaction tax would reduce our investment income, with consequences for the level of funding we can make

available for biomedical research in the UK and internationally, and for our other charitable activities.

6. The amounts of tax that could be imposed on transactions to which the Trust is a party is potentially significant. For example, based on our 2010 investment figures[1], we estimate that charging FTT on our transactions in listed equities at rates ranging from 0.1% to 1% (depending on the number of market intermediaries that are taxed – see paragraph 14 below) would result in an additional tax burden on the Trust of around £31 million, plus an additional £1 million from a 0.01% tax on derivative transactions. For comparison purposes, £32 million would be sufficient to fund either of the following:

    - More than 120 Sir Henry Welcome Postdoctoral Fellowships, which support the most promising newly-qualified postdoctoral researchers to make a start in developing their independent research careers.

    - A major overseas programme to carry out vital research on HIV, malaria, tuberculosis and other diseases that cause high levels of morbidity and mortality in low-income countries. £32 million is approximately the value of the Wellcome Trust's major overseas programme in Kenya, which employs over 600 people, 95 per cent of whom are Kenyan.

7. From an investment perspective, a FTT would reduce our flexibility and make it more difficult to tailor investment to manage our cash flow. If Europe were to introduce a FTT in isolation, this would decrease the Trust's incentives to invest in European markets.

8. We note that the Commission's proposal does not involve the setting aside of any part of the revenue raised by the FTT for the benefit of charitable organisations, as has been suggested in some quarters. If a FTT is introduced, we would argue that it should not apply to charities. This would be consistent with the existing charity exemptions from stamp duty taxes.

RESPONSE TO CALL FOR EVIDENCE QUESTIONS

9. We have responded only to those questions of relevance to the Wellcome Trust.

General questions on financial sector taxation – questions 1-3

10. The Wellcome Trust takes no position on whether there is a general case for the introduction of a tax on financial transactions. However, we question whether the stated objectives of the FTT, as proposed by the Commission, will be met and whether the FTT is an appropriate instrument for achieving those objectives. We note that the conclusion of representatives at an October 2011 Oxford University conference was that better targeted measures should be used, such as a financial activities tax, bank levies and/or regulatory measures[2]. We would also draw the Committee's attention to reservations about the FTT in previous Commission documents and more recent commentaries by professional advisers.

Specific questions on the Commission's proposal for an FTT

Rationale for an FTT and scope

[1] Total value of purchases and sales of quoted investments in year end 30 Sep 2010 was £5.6 billion.
[2] Conclusions presented by the University of Oxford Centre for Business Taxation Said Business School at the conference "Taxing banks: the role of tax in post crisis bank regulation".

Q4 What is your assessment of the Commission's objectives as contained in its proposal for an FTT? Are they fair and appropriate?

11. While the Commission's objectives appear to be fair and reasonable we question whether the FTT is an appropriate instrument to achieve them.

Q5 Does the Commission proposal for an FTT reflect the most desirable design for an FTT?

12. The FTT proposals are defective in a number of respects:

- ***The "financial transactions" that are taxed**:* The Commission proposals treat all transactions in financial instruments as taxable, with few exceptions. The most notable omission is the failure to provide an exemption for intermediary parties, which will produce a cascading effect on the aggregate tax rate borne by the customer (see further the response to Question 6 below).

- ***The definition of the "financial institutions" that are primarily liable to pay the tax:*** The definition of "financial institutions" includes a residual category of other "undertakings". The term "undertaking" is not defined, but in other EU contexts (e.g. State Aid and employment law) it has been interpreted broadly to encompass any entity that is wholly or partly engaged in an economic activity including a charity. The adoption of such an interpretation would be likely to bring many charitable organisations within the scope of the definition, with the result that those charities with significant endowments would become primary liable to the tax. As they would be engaging in financial transactions for their own account, the tax liability would reduce the resources available for application to their charitable purposes.

- ***The imposition of secondary joint and several liability for the tax on the customer:*** The imposition of secondary liability for the tax on the customer is objectionable in principle, particularly at a time when the financial stability of several financial institutions is in question, and even more so if the cost of the tax has been passed on to the customer in the pricing of the transaction.

Q6 On which transactions should the FTT be levied? Is it appropriate for the FTT to be levied on shares, bonds, derivatives and structured financial products as suggested by the Commission? What should be the rate of the FTT?

13. The scope of the FTT is highly relevant to the identification of which customers and other parties will bear the burden of the tax. It is not only customers with a high risk tolerance that make use of derivatives; it is now common practice for larger charities, pension funds, collective investment funds and other savings institutions to employ derivatives as part of their strategies to reduce the risks that are inherent in all investment portfolios.

14. It should also be noted that the current FTT proposal contains no exemption for most market intermediaries. Consequently, the proposal will have a significant cascading effect on the effective tax rate on a single transaction. A purchase of securities on the London Stock Exchange, for example, ordinarily involves the sale and purchase by a number of parties, including brokers, clearing members and the central counterparty to the clearing system. Each sale will be subject to the FTT (with only the central counterparty exempt), so a typical purchase by a charity or pension fund would result in the FTT "cascading", taking the effective rate for the transaction to 1% (if the original vendor is a financial institution) or 0.9% (if it is not). If the securities pass through market makers as well then the rate will be even higher. This represents a very significant hidden cost increase for UK charities – which currently pay no transfer taxes on bond

purchases or on the purchase of UK equities, and do not generally incur material transfer tax liabilities on similar transactions elsewhere in the EU .

Q7. *Is it appropriate for the FTT to be applied on the basis of the residence principle as proposed by the Commission? How likely is the residence principle to work in practice?*

15. It is likely that the use of the residence principle as a connecting factor for the imposition of FTT will prompt some institutions to relocate or divert business outside the EU.

Q8. *How significant is the potential for the FTT to raise significant revenues? How reliable would it be as a revenue stream? Where would the true incidence of the FTT fall? Should the revenues arising from the FTT be used to finance the deficits of Member States?*

16. Although the Commission suggests that the FTT could raise an additional EUR 56 billion (0.08% of GDP) per year from 2014 onwards, its impact assessment also estimates that the tax would reduce long-term GDP in the EU within a range of 0.53% to 1.76%. Such a contraction in the long-term growth rate of the EU would inevitably raise questions about the effect on the revenue yield from other taxes and the additional costs to governments of a prolonged period of limited economic growth.

17. Another facet of the FTT proposal that needs to be factored into the overall assessment of its revenue raising potential is the requirement for Member States to abolish existing taxes that are considered to be incompatible with the FTT. For the UK this would mean an immediate loss of the annual £4 billion tax revenue raised by the imposition of stamp duty and stamp duty reserve tax on share purchases.

18. The nature of the FTT is such that its cost can easily be passed on to the customer in the pricing of the transaction. Accordingly, it is likely that at the least a significant part of the tax burden will be borne not by the financial sector but by individual savers and other customers.

19. In contrast to stamp tax revenues, which are wholly retained by the UK Government, it is proposed that part of the FTT revenues should be used to fund the EU budget. This would result in a disproportionate contribution by the UK due to the significantly higher tax base of the UK financial sector compared to that of other Member States.

Impact and effectiveness

Q9. *Would the Commission's proposal for an FTT be effective in addressing short term volatility and curbing harmful speculation? Would it reduce excessive risk taking?*

20. The proposal should be effective in curbing speculation and excessive risk taking to the extent that the imposition of the tax makes such transactions uneconomic. However, it also runs the risk that similar transactions by customers seeking to manage financial risk in a responsible manner will likewise become uneconomic. For example, the distinction between foreign exchange transactions that are conducted on a spot basis (exempt) from those that are planned in advance (taxed) has the potential to incentivise inefficient behaviour.