LEGAL OPINION

Regarding the EU law assessment of the ministerial memorandum "Riskskatt för vissa kreditinstitut" (Risk tax for certain credit institutions), particularly in relation to EU state aid regulations

1. The assignment

In September 2020, the Ministry of Finance presented a memorandum (Fi2020/03725/S1, hereafter referred to as the Memorandum) in which it is proposed that Sweden introduces a new risk tax act for certain credit institutions, intended to enter into force on 1 January 2022. The Swedish Bankers' Association is a consultation body. As part of the consultation, the Swedish Bankers' Association has tasked me with making a legal assessment of the bill with a special focus on how it can be expected to relate to the EU state aid regulations.

I have read the Memorandum and have also received supplementary information from the Swedish Bankers' Association regarding the relevant circumstances. I would like to state the following.

2. A summary of the factual circumstances

In many ways, the Memorandum proposes a new type of taxation of banks and credit institutions. Unlike normal and widely accepted practice, it is not aimed at taxing the companies' income. Rather, the proposed object of taxation is the companies' liabilities. The new proposed tax, referred to as a risk tax, is also not general, but only affects banks and credit institutions whose liabilities exceed a certain threshold. This threshold has, without any given justification, been set to SEK 150 billion for 2022, calculated on a consolidated basis. The threshold is indexed. The basis for the calculation is the liabilities attributable to the bank's or credit institution's operations in Sweden, see Section 3 for more.

The Swedish Bankers' Association has calculated that the proposed "risk tax" would affect nine banks and credit institutions, while the rest would be exempted. The tax would hit the affected companies hard, with the proposed tax rate being 0.06 per cent for 2022 and 0.07 per cent for 2023 and later years. According to the Swedish Bankers' Association's calculation, this corresponds to an increase in the corporate income tax rate from 20.6 per cent to around 30 per cent.

In other words, the tax that is now proposed in Sweden is a completely new type of tax with a special structure and major tax-raising effects.

3. Lack of competitive neutrality

It can be concluded that the design of the proposed tax is not neutral as it only affects certain large credit institutions. This lack of neutrality is evident in two separate aspects.

As the proposed new tax only affects banks and other credit institutions whose liabilities exceed SEK 150 billion, calculated on a consolidated basis, the tax does not affect banks and credit institutions whose liabilities are below this threshold. This includes all savings banks, other medium-sized and small banks, as well as several actors on the mortgage market. The market share of the companies that are not affected by the tax varies, primarily depending on what type of service they provide, but also by geographical market. On the market for bank deposits from Swedish households, the market share for the institutions not affected by the tax was 27 per cent in 2019. On the market for new mortgages, the equivalent market share was 23 per cent during that same year. This creates a clear distortion in terms of competition. The Swedish Bankers' Association has pointed out that the smaller banks and credit institutions are engaging in fierce competition, and that their market shares tend to grow.

The proposed new tax is also delimited in that the proposed basis for calculating the threshold value, SEK 150 billion, are liabilities attributable to the credit institutions' operations in Sweden. The tax is also proposed to include foreign banks with branches in Sweden and whose Swedish operations have liabilities that surpass the threshold. Liabilities attributable to foreign activities of Swedish banks and credit institutions would also be subject to the proposed tax if these activities are conducted within the scope of lending money from Sweden. However, in some respects, there appears to be some uncertainty regarding what is intended to be included when calculating the threshold value. Swedish banks lend significant amounts to businesses that conduct activities abroad, and foreign banks provide loans to Swedish enterprises. The later falls outside the scope of the activities that would be covered by the proposed new tax to the extent that they are not conducted through a Swedish branch. The Swedish Bankers' Association has pointed out that on average, 15–20 per cent of the lending conducted by Swedish banks is made in fierce competition with foreign banks who would not be subject to the proposed tax. This causes a significant distortion in terms of competition.

The distortive effects are reinforced since the new proposed tax would entail a significant threshold effect. An institution that passes the threshold of SEK 150 billion are therefore subject to a direct and immediate tax effect in the range of SEK 100 million.

In conclusion, the proposed tax has considerable shortcomings in terms of competitive neutrality.

I will return to the topic of insufficient competitive neutrality in Section 5 to discuss it from a state aid perspective.

4. Does the proposed tax have a convincing justification?

The Swedish Bankers' Association has asked me to consider if the proposed "risk tax" has been convincingly justified.

The proposed tax is justified by the risk of large credit institutions causing large costs to society in the event of a financial crisis, and that this justifies imposing a special "risk tax" on these companies. As a background, the Memorandum calls back to the financial crisis of the 1990s and the extensive banking crisis management carried out by the Government at the time. The 2008 financial crisis is also mentioned. However, this had limited impact on public finances.

Furthermore, the Memorandum emphasises that the major banks in particular have a central role in the economy. The Memorandum also states that the proposed tax is "designed to reinforce the public finances and thus create the space needed to manage a future financial crisis" (p. 24), and that "the tax is designed to compensate for indirect costs in Sweden in the event of a financial crisis" (p. 25). The Memorandum also contains the statement that "a high degree of risk taking by the credit institutions increases the likelihood of a financial crisis, and substantial costs to society" (p. 23). It is however not proposed that the new revenue from the proposed tax would be earmarked or funded for use in a potential future crisis. The proposal is designed purely as a tax increase that would bolster the revenue side of the national budget. As the proposal is currently phrased in the Memorandum, there is nothing preventing the new tax revenue from being used to pay for increases in government expenditure of any kind. This makes it unclear as to what the actual purpose and legitimate interests are for the proposed tax.

The presented justification for the new tax ignores and does not consider the fundamental changes that have occurred since the financial crisis of the 1990s when it comes to preventing and managing financial crises.

What is most notable in this respect is the special procedure, resolution, which has been in effect since 2016 for financial businesses who have ended up in a crisis, more specifically banks and other major credit institutions. The provisions pertaining to resolution are based on an EU directive regarding crisis management and is generally in line with the applied regulations within the EU Banking Union.[1] The fundamental purpose of resolution is to reconstruct or liquidate important financial companies that fail, if possible, without causing significant disruptions or interruptions in essential activities. However, only system-critical banks and any other financial businesses of this nature may be subject to resolution. In the event of a resolution, the shareholders and creditors shall carry the losses to the greatest extent possible. The state's role has been limited to a last resort to save system-critical companies. Funds set aside in the resolution reserve can therefore be used for bail-ins, conversion of liabilities to equity and recapitalisation. The state can also guarantee protected investments through the Swedish National Debt Office.

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[1] See Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, Government Bill 2015/16, "Genomförande av krishanteringsdirektivet" (Implementation of the crisis management directive) and Ulf Bernitz, "Bankstöd och resolution i Sverige och EU" (Bank aid and resolution in Sweden and the EU), Fstschrift for Göran Millqvist, 2019 p. 153 pp.

What characterises the regulations surrounding resolution is that they can only be used under strict conditions. In order to avoid a moral hazard, i.e. preventing the owners from relying on government support in a crisis, the regulatory framework is only aimed at the reconstruction of system-critical companies in a crisis. Other financial companies are assumed to be liquefiable in a crisis. Through this EU regulatory framework, the conditions for providing government support for banks and other credit institutions facing financial difficulties are strictly regulated and limited. The situation is therefore completely different than it was during the financial crisis of the 1990s, when, as we know, a substantial amount of government aid was paid out to banks etc. The EU-based regulatory framework for resolution means that a similar massive state support effort is no longer possible. The Memorandum's reference to the financial crisis of the 1990s is consequently misleading.

The Memorandum also does not consider that Sweden has allocated large financial reserves for the crisis management of companies facing difficulties. The Swedish charges to the resolution reserve are significantly higher than what the EU regulations require and what is generally applied throughout Europe. At the end of 2019, the resolution reserve amounted to SEK 43.5 billion and is managed by the Swedish National Debt Office. Also worth noting is that a special assistance act was introduced in Sweden in connection to the 2008 financial crisis. The assistance act ordered credit institutions, in particular banks, to pay fees to a special stability fund. The fund has been maintained since the creation of the resolution regulatory framework and the resolution reserve. The purpose of the stability fund, which is also managed by the Swedish National Debt Office, is somewhat unclear now that Sweden has introduced a special resolution order. However, it remains available for support measures. The stability fund is worth around SEK 40 billion. Additionally, there is a deposit guarantee fund amounting to SEK 44 billion funded by banks and other credit institutions. It is intended to ensure the government deposit insurance, based on EU law.

In other words, the Swedish Government has access to large financial reserves intended for use in the event of a financial crisis that may affect the banks and other credit institutions.

Furthermore, Sweden applies particularly high capital adequacy requirements for banks, by international standards.

Considering the strict set of criteria that need to be met to implement resolution, the substantial financial means available to the Swedish Government for support measures, in addition to the high capital adequacy requirements imposed in Sweden, the justification for the proposed tax is not convincing. It is highly unclear how the new tax revenue this tax would generate is intended to be linked to the state's capability to conduct crisis management in the event of a serious financial crisis. The explanation provided in the Memorandum regarding the purpose of the proposed new tax appear to be highly misleading. The proposals made in the Memorandum are essentially nothing more than a new tax which generally increases the state's revenue, and thereby contributing towards widening the Government's spending capabilities for various purposes. However, the fact remains that the provided justification for introducing a "risk tax" on the large banks' and credit institutions' liabilities is that, despite the regulations and supervision already imposed on the credit institutions and the support capabilities, there is supposedly still a need for new tax revenue to cover the support measures and similar efforts in the case that a new financial crisis arises in the future.

In conclusion, the justification provided for the proposal to introduce a new type of tax, based on the liabilities of large banks and credit institutions, does not appear convincing considering the strict set of criteria that need to be met to implement resolution, the substantial financial means currently available to the Swedish Government for support measures, in addition to the high capital adequacy requirements imposed in Sweden.

5. Is the design of the proposed tax compatible with the state aid regulations outlined in EU law?

In the Memorandum, the assessment is made that the design of the new tax should be compatible with EU regulations regarding state aid. The Swedish Bankers' Association has asked me to evaluate whether this assessment can be considered correct.

As concluded in Section 3, the proposed tax is not neutrally designed and only affects certain big banks and other credit institutions. In that section, I also highlighted shortcomings regarding the formulation in terms of competitive neutrality.

There is reason to further consider whether this bias can constitute favouring/disadvantaging of businesses to the degree that it would constitute unlawful state aid according to the EU state aid legislation. The starting point for a legal assessment of this issue is the European Union law's fundamental provision prohibiting state aid in Article 107(1) in the Treaty on the Functioning of the European Union (TEUF), which reads:

"Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

Unlawful state aid does not need to take the form of a payment of financial benefits or the like from public funds. It can also take the form of companies having financial benefits or incurring financial disadvantages through a lack of neutrality when deciding what taxes and fees should be paid to public funds.[2] It bears pointing out that the term "financial benefit" has a broad interpretation when discussing state aid and includes every financial advantage or benefit which a company would not have received under normal market conditions.[3]

An unproblematic starting point for the following is that Swedish banks and credit institutions normally conduct activities that at least in some capacity affects one or multiple other EU/EEA countries beyond Sweden, often several such countries. The basic EU law requirement that the trade between member states shall be affected for the regulations on state aid to be applicable has therefore been fulfilled.

Furthermore, it is clear that the proposed new tax is not included in the special exemptions within the regulatory framework regarding state aid for regional aid, cultural aid, remedying serious financial disturbances etc. in Article 107(2) and 107(3) in the TEUF. It is also not covered by the regulation through which these aid categories are declared compatible with the internal market.[4]

A central starting point for the assessment is that taxes, and comparable charges, which through a lack of neutrality cause a selective disadvantage to some companies, may be considered unlawful state aid as they entail higher costs for these companies. Taxes and fees that entail a selective disadvantage can, from a state aid point of view, constitute an unlawful advantage to other companies that are not subject to the costs. As mentioned, the treaty text quoted above discusses how this can "distort competition by favouring certain undertakings or the production

[2] See C. Quigley, European State Aid Law and Policy, 3 ed., Oxford 2015.
[3] The Commission's declaration of the term "state aid" as referred to in Article 107.1 of the Treaty on the Functioning of the European Union (2016/C 262/01), para 66.
[4] Commission Regulation (EU) 651/2014 through which certain categories of support are declared compatible with the internal market according to articles 107 and 108 of the treaty.

of certain goods." Tax selectivity is a well-known form of state aid. When assessing whether this is a case of such selectivity, it is common to apply a three-step approach.[5]

In the first step, a reference system is identified in the form of a demarcation to serve as a benchmark for the assessment.

In the second step, it shall be established whether a certain measure, in this case a tax increase, constitutes an exception from the reference system in that the measure distinguishes between economic actors in a factual and legally comparable situation. In this respect, the goals the measure seek to achieve shall be considered. If a distinction is made between persons in a comparable situation, the measure is to be regarded as selective.

As a third step, it shall be examined whether the selectivity can be motivated by what is commonly referred to as the nature and the general method of the reference system. The analysis is then conducted in the following order.

The first step is, as mentioned earlier, the demarcation of the frame of reference. In this case, where the starting point is tax based on liabilities, it seems that considering the design of the tax, the frame of reference for the assessment should be limited to banks and credit institutions whose activities include lending money to customers in the Swedish market. These companies are market actors that, within certain frameworks, conduct similar activities on the same market, and are presumed to be able to compete on equal footing. This means they are in a comparable situation, where the main principle is equal treatment in terms of taxation.[6]

The Memorandum makes a different assessment on this point, see p. 35. It emphasises that the significance of a specific credit institution on its influence on the financial system depends on the size of the institution and the complexity of its activities. It is claimed that only the institutions that are saddled with the new tax in the proposal constitute a potential risk of significant indirect costs to society. As such, they are in a different legal and factual situation with regards to the purpose of the tax compared to other banks and credit institutions. The

[5] Commission Notice on the notion of State aid (EUT C 262, 19/7/2016 para 128 pp. and section 5.4. This three-step approach is used by the Court of Justice of the European Union when determining whether taxation regulations are formulated in a manner that violates the state aid regulations, see for example the cases C-20/15 P and C-21/15 P, EU:C:2016:981, World Duty Free Group etc., and case C-203/16 P, Dirk Andres v European Commission, EU:C:2017:1017, in particular Advocate General Wahl's statement in the case. See also, among others, J. Monsenego, Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base, Kluwer Publ., 2018.

[6] Equal competitive grounds and measures to limit competitive distortions were thoroughly assessed aby the Commission in decisions such as K(2010) 3124 final regarding state-funded reconstruction support for the Swedish Carnegie Investment Bank.

Memorandum appears to be based on the perception that the frame of reference which should be used for the legal assessment concerning state aid should only cover the companies that would be liable to pay taxes under the proposal. In other words, these companies are placed into a category of their own.

This narrow demarcation of the frame of reference does not appear convincing. No documentation is presented to indicate on what basis the lower tax liability threshold has been established. The threshold appears to be rather arbitrary. In addition, companies under the threshold could cause significant indirect costs should they fail, with the possible exception of small actors. As previously mentioned, banks and credit companies in Sweden conduct largely similar activities on the same market and are presumed to compete on equal footing, regardless of whether they are above or below the proposed threshold that would make their liabilities taxable.

In conclusion, the frame of reference should, unlike the reasoning in the Memorandum, include banks and credit institutions whose activities include lending money to customers on the Swedish market irrespective of any threshold.

As mentioned previously, *the second step* entails an assessment of whether the proposed tax distinguishes between banks and credit companies that are in a similar factual and legal situation, i.e. which belong to the same frame of reference.

As highlighted above in Section 3, the proposed tax falls short in two respects of competitive neutrality.

One situation relates to the relationship between particularly large banks and credit institutions on the Swedish market and other, relatively smaller actors on the same market. As the proposed new tax only affects banks and credit institutions whose liabilities exceed the threshold of SEK 150 billion, when calculated on a consolidated basis (currently a total of nine companies or groups), the tax does not affect Swedish banks and credit institutions whose debts are below the threshold. This includes all savings banks, other small and medium-sized banks, as well as several actors on the mortgage market. In several important submarkets, the institutions not affected by the tax has total market shares of 20 per cent or higher. The proposal of a threshold for taxable liabilities set to SEK 150 billion is not compatible with the fundamental principle of tax neutrality as it does not affect companies whose lending is below the threshold. This means that the proposed tax would have a selective impact, distortive effects in competitiveness and run counter to the fundamental principle of equal treatment and tax neutrality.

The other situation pertains to the relationship between foreign banks and the Swedish banks and credit institutions which, according to the Memorandum, are liable to also pay taxes on the liabilities in their Swedish balance sheet which is used to fund lending in strong competition with foreign banks and credit institutions without this occurring via their Swedish branch. It could, for example, concern funding of Swedish exports or foreign activities conducted by Swedish businesses. The Swedish Bankers' Association estimates that this type of lending amounts to an average share of 15–20 per cent of the basis for the tax. In this scenario, the proposed tax would have a selective impact and a distorting effect on competition.

On this point, the Memorandum makes a different assessment by, as previously mentioned, assuming that the banks and credit institutions that would be liable to pay the new tax make up a separate category (see p. 35). According to the Memorandum, the frame of reference only includes these companies. On that basis, the Memorandum draws the conclusion that the fact that other credit institutions will not be taxed does not entail a selective advantage for these companies from a state aid point of view.

As previously mentioned, the Memorandum's assessment of the frame of reference is not convincing. If you base your argument on a frame of reference that includes the banks and credit institutions whose activities involves lending money to Swedish market regardless of any threshold, as seems to be the correct approach, the proposed tax is clearly applied selectively and creates a distortion in terms of competition.

One possible objection that is to some extent in line with the reasoning in the Memorandum would be that the proposed tax affects the majority of lending from Swedish banks and credit institutions, and that therefore the selectivity, by its design, would not be of any real significance. As shown, the tax does not affect small and medium-sized Swedish banks and credit institutions and also does not include foreign banks in direct competition with Swedish banks, to the extent that these activities do not take place within the framework of a Swedish branch (see Section 3 above). It is however enough for a small number of companies to benefit or be disadvantaged by selective tax measures for said benefit or disadvantage to be present to the extent that the state aid regulations could be considered applicable.[7] The objection that the proposed tax would only exclude a relatively small portion of the market and thus be acceptable can therefore not be considered viable.

[7] See for example the Commission's decision 29 June 2016, C (2016) 4809 final (no. SA.42007) para 43, regarding turnover tax of the Belgian diamond sector.

In conclusion, this all means that the proposed tax is selective by distinguishing between actors in a comparable situation and by falling short in terms of competitive neutrality. Consequently, we need to move on to step three to test whether the circumstances are such that the design of the tax is acceptable from a state aid point of view.

The third step means, as mentioned, examining whether the selectivity can be motivated by what is commonly referred to as the system's nature or general method. This step examines the purpose or objective of the proposed tax and if this makes it possible to justify the tax when considering the purposes behind the EU and its state aid ruels.[8] To list an example, a certain demarcation of an environmental tax in a specific area can be justified by considerations aimed at directing or limiting a certain type of consumption which is deemed less appropriate from an environmental protection perspective. Such a demarcation can be fully compatible with EU law.

Thus, when assessing whether the selectivity inherent in the design of the proposed new tax can be considered acceptable when conducting an assessment in accordance with the EU state aid regulations, you have to assess the purpose of the tax against the background of EU law and the design of the state aid regulations.

The purpose of the proposed tax has been discussed in the Memorandum and Section 4 above. As has been shown, the introduction of the tax and its structure are justified by the claim that large banks and credit institutions risk causing major costs to society in the potential scenario of a financial crisis. The Memorandum also states (p. 23 pp.), among other things, that the big banks have a central role in the national economy, that the proposed tax is "aimed at strengthening public finances and thereby create space to manage a future financial crisis," that "the tax is intended to compensate for indirect costs in Sweden in the event of a financial crisis," and that "a high degree of risk-taking by the credit institutions increases the likelihood that a financial crisis will occur, thus causing significant costs to society". The credit institutions that would be subject to the proposed tax "present a potential risk of causing indirect costs to society". The purpose is also indicated by the proposed name "risk tax".

In the Memorandum, it is stated that there is no legal practice regarding how the proposed tax system would be assessed based on the EU state aid regulations (p. 35).

[8] Para 139 of the Commission's notice on the notion of the term "state aid" uses the example of the need to fight fraud and tax evasion, the need to rationalise specific accounting requirements and administrative manageability.

The main purpose of the proposed tax is clearly to provide the Swedish Government with a bolstered buffer for implementing measures in the event of a new financial crisis. However, it needs to be noted that these significant indirect costs to society are never defined. Such measures would likely at the very least have the character of support measures as defined by EU law. However, as has been shown, the state's capacity to intervene through support measures to aid banks and other credit institutions facing financial difficulties is now, by design, highly limited due to the regulatory framework regarding resolution. State aid shall not be provided to companies that are financially weak in situations that fall outside of the scope of resolution. Given that this is a well-established fact, it is somewhat unclear what kind of support measures etc. the new financial buffer is intended to fund.

When it comes to evaluating how the proposed tax relates to the third step of the assessment according to the EU state aid regulations, it must be assessed whether the tax can be justified considering the purposes underlying these regulations. The assessment is complicated to some extent by the ambiguity of the new buffer for measures to be taken by the Swedish Government and how these would be implemented. As the proposed tax is formulated and justified, it is difficult to see how it would be compatible with the EU's view on support measures, and thus be deemed acceptable in an assessment made in accordance with the third step.

In conclusion, it is my assessment that the proposed "risk tax" is most likely contrary to the EU regulations on state aid due to its selective design, its distorting effects on competition, and its focus on building a buffer for some form of support measures to be implemented by the Swedish Government, the application of which seem at odds with the EU's view of what constitutes acceptable support measures.

6. Notification and examination of state aid

The Memorandum states (on p. 34, among others) that even if the proposal for some credit institutions to pay a risk tax to the state does not constitute state aid, the intention is to notify the European Commission of the proposal in order to obtain legal certainty. A reasonable interpretation is that the Ministry of Finance has come to the same conclusion that the proposal is dubious from a state aid point of view.

Such a notification shall be made according to Article 108(3) of the TEUF. The notification shall be made well in advance so that the Commission has a chance to comment on all the plans to adopt or change the aid measure. In this respect, according to Article 108(3) of the TEUF, the prohibition on implementation applies, which means that a member state is prohibited from implementing unnotified state aid.

If the Government Offices decides to move forward with the bill in the Memorandum and submit a notification to the European Commission, the Swedish Bankers' Association should consider making a formal complaint to the Commission around the time the notification is submitted. There is a specific form for this.

7. Conclusions

With reference to the arguments I have presented, I conclude the following

That the justification provided for the proposal to introduce a new type of tax, based on the liabilities of large banks and credit institutions, does not appear convincing considering the strict set of criteria that need to be met to implement resolution, the very substantial financial means currently available to the Swedish Government for support measures, in addition to the high capital adequacy requirements imposed in Sweden,

That the proposed tax is selective by distinguishing between actors in a comparable situation and by falling short in terms of competitive neutrality,

That the proposed tax is most likely contrary to the EU regulations on state aid due to its selective design, its distorting effects on competition, and its focus on building a buffer for some form of support measures to be implemented by the Swedish Government, the application of which seem at odds with the EU's view of what constitutes acceptable support measures,

That if the Government Offices decides to move forward with the bill in the Memorandum and submit a notification to the European Commission, the Swedish Bankers' Association should consider making a formal complaint to the Commission around the time the notification is submitted.

Stockholm, 5 November 2020

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