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European Commission Proposes Rules for 11 Member State Financial Transaction Tax

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The European Union Financial Transaction Tax (EU FTT) is back on the agenda. While only 11 EU member states will now apply the EU FTT, the effect is likely to be felt more widely.

The Directive on the EU FTT that was originally proposed in September 2011 would have covered all 27 EU member states. Following opposition from several member states, a group of 11 – Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain (together, the FTT Zone) – have pressed on under the little-used "enhanced cooperation" procedure, whereby some EU member states can adopt a Directive that does not apply to the other member states.

The European Commission published a revised draft Directive on 14 February 2013 to implement the EU FTT in the FTT Zone. The draft Directive will require unanimous agreement between the FTT Zone states. If agreement is obtained, the EU FTT is proposed to come into force on 1 January 2014.

Overview

Subject to the inclusion of the "issuance principle" (see below), the main proposals in the revised Directive broadly track the framework of the September 2011 draft. In summary, the framework is as follows:

- To charge the EU FTT on transactions in a wide variety of financial instruments, structured securitisation products and derivatives. Primary securities issuances, loans and spot currency transactions are not intended to be included;

- To provide for an FTT Zone state to impose the EU FTT charge on, potentially, each financial institution which is party to such a transaction and which comes within the "residence principle". "Financial institution" is defined very widely, and may include pension funds and other collective investment schemes. Broadly, the charge under the residence principle applies where:

  - The financial institution is established or resident in, or acting through a branch in, the FTT Zone state,

  - The financial institution is acting under a regulatory authorisation from the FTT Zone state (including through a regulatory passport into that FTT Zone state), or
  - A financial institution which is otherwise outside the scope of the charge enters into a transaction with a financial institution that is within the charge, or enters into a transaction with a non-financial institution party that is itself in an FTT Zone state;
- Where the EU FTT applies, the relevant financial institutions are primarily liable. However, each party to the transaction – including persons other than financial institutions – is jointly and severally liable if the EU FTT is not paid on time. While there is an exemption from the primary charge for central counterparties, conducting a transaction on an exchange in the FTT Zone may itself cause the charge to apply to other parties; and
- To set a minimum rate of 0.1% of transaction value, or 0.01% of the notional amount in the case of derivatives. Each FTT Zone state is free to set its own rate at or above the minimum.

Issuance Principle and Other Changes

The scope of the EU FTT has been significantly extended, compared with the September 2011 proposals, to include the "issuance principle". This is described as an anti-avoidance measure to address the incentive for financial institutions to relocate in order to avoid the EU FTT.

Under the issuance principle, the EU FTT will also cover transactions in financial instruments where the issuer of the relevant financial instrument is in the FTT Zone, potentially even if all of the parties are themselves outside the FTT Zone. This head of charge may also catch derivatives traded on an organised platform. There is an exemption where it can be proved that there is no link between the FTT Zone and the economic substance of the transaction. Depositary receipts and similar wrappers which are issued with the essential purpose of avoiding the EU FTT charge will be treated as having been issued in the state of the underlying security, so that the EU FTT remains chargeable where the issuer of the underlying security is in the FTT Zone. If trade in the depositary receipt or other wrapper has replaced trade in the underlying security to a significant extent, it will be for the person liable to the EU FTT charge to demonstrate the absence of the avoidance purpose.

The draft Directive contains other changes to the September 2011 proposals. A material modification of a taxable transaction will now give rise to a separate EU FTT charge. An anti-abuse article has also been introduced, stating that artificial arrangements put in place for the essential purpose of avoiding tax are to be ignored.

Comment

Pitfalls that were identified in the September 2011 proposals remain in the present draft. There is no comprehensive relief for transactions within a corporate group, and no financial intermediary exemption. The absence of the latter exemption raises the prospect of multiple EU FTT charges arising on a single transaction, as typically several financial institutions would participate as brokers and market-makers in the settlement of exchange trades. In addition, the charge on derivatives could inhibit ordinary hedging transactions.

While the territorial scope of the EU FTT has been narrowed to 11 EU member states from the original 27, the issuance principle and the imposition of a charge if any party is in the FTT Zone have the potential to affect many transactions taking place in countries beyond the four corners of the FTT Zone. Although domestic FTTs in FTT Zone states (such as the French FTT applicable since 1 August 2012) will have to be repealed once the EU FTT comes into force, there remains scope for double taxation – for example, where a financial institution in the FTT Zone is party to the sale of shares in a UK company, both the EU FTT and UK stamp duty reserve tax could apply.

The suggested 1 January 2014 implementation date leaves little time for market participants to consider the impact of the EU FTT on their pricing structures, and to introduce systems to track the location of the parties to a transaction and ensure that the EU FTT is paid when due. Financial institutions will need to monitor developments closely.

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