Global Tax practice

Financial Transaction Tax

Sending shock waves through global financial services
Contents

Introduction 3
Part I: Scope of the FTT and potential impact 4
Part II: Is the FTT legal? 19
Part III: Impact in particular jurisdictions 25
  Belgium 26
  France 28
  Germany 31
  Italy 33
  Luxembourg 36
  Netherlands 38
  Spain 40
  United Kingdom 42
Introduction

If it is implemented as proposed, the financial transaction tax (FTT) is likely to cause distortion to the financial sector, both within the EU and outside and will almost certainly change the way we do business. As a result, some activities may relocate out of the affected area. Some product lines might be pulled altogether as a result of increased costs.

That is why, with this brochure, we intend to provide useful insights into the FTT as such and an overview of how this proposal is assessed. In Part I of this brochure we look at the scope of the tax and its potential impact. In Part II we address the question of its legality. We finish in Part III by examining the impact in particular jurisdictions, such as Belgium, Germany, France, Italy, Luxembourg, Netherlands, Spain and the UK. Nonetheless, we have to point out that the content of this brochure represents evaluations which might be subject to change as the discussion on FTT within the EU progresses. Against this background, it should be remembered that the considerations included are viewed at a particular moment. However, we will keep you updated on this topic.

We hope this brochure proves useful to you and your business. Your usual Allen & Overy contact and our local tax experts would be delighted to assist and support you on any issue related to this topic. Contact details are included in Part III of this brochure.

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Part I

Scope of the FTT and potential impact
BACKGROUND

The proposal for an FTT to be adopted by 11 Member States of the EU comes out of an initiative aimed EU-wide that failed. The FTT was initially proposed by the European Commission in the wake of the financial crisis. The Commission looked at different options, including a financial activities tax, but settled on the FTT as the better course. In September 2011 the EU Commission proposed an FTT for the whole EU, but some Member States (such as Luxembourg, Sweden and the United Kingdom) rejected the proposal. Despite this, sufficient support for the FTT remained for it to apply to Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the FTT zone). These are the participating Member States. Some of the participating Member States in the FTT zone have already implemented their own domestic FTTs or are in the process of doing so, which helps the Commission’s argument that an FTT for the FTT zone is needed to avoid fragmentation.

This is the first time that the EU has considered a proposal for a partially harmonised tax. It relies upon a little-used procedure within EU Treaties, the enhanced cooperation procedure (ECP). After the EU Council authorised the use of the ECP for the FTT on 22 January 2012, the Commission issued a revised proposal for the tax on 14 February 2012. This proposal is largely based upon the original proposal.

The objectives of the FTT are to:

– harmonise legislation concerning indirect taxation on financial transactions,

– ensure that financial institutions make a fair and substantial contribution to covering the costs of the recent crisis and creating a level playing field with other sectors from a taxation point of view, and

– create appropriate disincentives for transactions that do not enhance the efficiency of financial markets, thereby complementing regulatory measures to avoid future crises.
Revised proposal in brief

The FTT will be imposed by participating Member States only. It is imposed on a broad range of financial institutions.

It is not a tax merely on the trading of shares, bonds and other securities. There is a significant charge on the taxation of derivatives, which may make some derivative products uneconomic.

Financial institutions established in the FTT zone will be subject to the FTT when they buy and sell securities, conclude derivatives and materially modify either transaction.

There is an extra-territorial dimension to the tax. It will not simply apply to financial institutions with a legal or physical presence in the FTT zone or with regulatory authority to operate there. Merely transacting with a counterparty in the FTT zone (whether or not the counterparty is a financial institution) will subject the other party to the FTT.

Following changes in the revised proposal, the FTT is not based upon the location of the parties to the transaction alone – it is also based upon the location of the underlying security being traded. This means that if a security is issued by an entity incorporated in or registered in the FTT zone, any party to the sale of the security will be subject to the FTT, wherever they are located.

An institution will be chargeable whether it is acting on its own account or for the account of others, unless it is acting in the name, or for the account, of another financial institution. Significantly, there is no wide market maker exemption, which will result in multiple charges on the simple sale of securities over an exchange.

There are exemptions for limited types of transactions (eg primary market transactions and spot currency transactions) and limited institutions (eg central counterparties and central securities depositaries). However, central counterparties and central securities depositaries are expected to have a significant role in collecting the FTT.

The FTT on buying and selling securities will be charged at a minimum rate of 0.1%. The minimum rate which applies to concluding or modifying derivatives is 0.01%.

The FTT could apply to both counterparties to a transaction.

There is a general anti-abuse rule to prevent avoidance of the FTT, with specific provisions aimed at depositary receipt programmes.
STRUCTURE OF THE PROPOSAL

The revised proposal provides for a broad-based FTT charged on “financial institutions” on “financial transactions”.

FINANCIAL INSTITUTIONS

A wide range of entities will be brought within scope – not just those within the financial sector. “Financial institution” has a wide definition which includes banks, investment firms, regulated markets, insurers, undertakings for collective investment in transferable securities (UCITS), pension funds and securitisation special purpose entities. Persons carrying out a significant level of certain financial activities (including finance leasing or acquiring holdings in undertakings) are also included. The revised proposal clarifies that activity will be significant where the average annual value of an entity’s financial transactions is more than 50% of its overall average net annual turnover. Under the original proposal there was a concern that this could catch holding companies, including passive holding companies (whether or not in the financial sector). The averaging test in the revised proposal may help a passive holding company cease to be a financial institution after a period of time provided it has not acquired new holdings or participated in other activities resulting in it continuing to be a financial institution. However, other holding companies or vehicles could be within scope. This means that the tax will become relevant to straightforward M&A transactions, e.g. the sale of an Italian company by a private equity fund.

The charge will attach to a financial institution, whether it is acting on its own account or for the account of another person, or it is acting in the name of a party to the transaction. It is exempted if it is acting in the name or for the account of another financial institution, who may itself still suffer the tax (see page 12 under Exemptions).
FINANCIAL TRANSACTIONS

Transactions within charge are:

**The purchase and sale of a “financial instrument” before netting or settlement**

The charge applies potentially for both the buyer and seller if they are both within the jurisdictional reach of the FTT. There is no change to the definition of a financial instrument in the revised proposal, which means that the FTT still applies to transferable securities (eg shares and bonds), money-market instruments (eg commercial paper), units in UCITS and alternative investment funds, financial derivatives of all kinds and structured products.

**The conclusion of “derivatives contracts” before netting or settlement**

The definition of derivative contract includes a variety of different types of options, futures, swaps, forwards, financial contracts for differences, and other types of derivative.

**Other intra-group transactions which in economic terms involve a transfer of risk, but do not amount to a sale or purchase**

Where financial instruments whose purchase and sale is taxable form the object of a transfer between separate entities of a group, this transfer shall be taxable even though it might not be a purchase or sale.

**An exchange of financial instruments**

An exchange will amount to two transactions (purchase and sale) rather than just one.

**Repos, reverse repos and securities lending and borrowing agreements**

These will be subject to FTT, but will give rise to one transaction only following a change from the original proposal. This will benefit financial institutions that rely heavily on repo transactions, although it would have been preferable for such transactions to be excluded entirely given the heavy reliance by some financial institutions on the repo market, eg institutions that use repos as a cash management tool and as a substitute for less attractive transactions with central banks.
Any “material modification” of the transactions mentioned above

Under the original proposal any modification of a derivative contract (but not other types of financial transaction) would have been taxed. Under the revised proposal, it is only material modifications which give rise to a charge. However, this will apply not just to derivative contracts but to all types of financial transaction. The revised Directive provides that a material modification includes substituting at least one party or changing the time period or the consideration of a transaction. Note that there is no grandfathering of existing transactions in relation to material modification. Assuming the FTT is introduced in January 2014, it would apply to a material modification made after January 2014 of a transaction entered into before that date.

A key concern is that there remains uncertainty about how the FTT will apply to derivative contracts despite the clarification that only material modifications will be taxed and that the charge will (following changes to the original proposal) apply only “before netting and settlement”. Tying the charge to the conclusion of the derivative contract before netting and settlement suggests an intention that the FTT should be charged upfront, however the language is not clear because “conclusion” is an unclear concept for derivatives. A concern about multiple incidences of charge for derivative transactions remains. A novation of a derivative contract would trigger a further charge, but the same could also apply to other material amendments or rolls.
JURISDICTIONAL SCOPE OF THE PROPOSAL

The jurisdictional scope of the proposal is one of the most contentious elements of the proposed tax. There are a number of bases on which a financial institution can be brought within the jurisdictional reach of the FTT. These are as follows:

**A financial institution that has a legal or physical presence in the FTT zone.**

The tax will apply to the worldwide operations of a financial institution in the FTT zone, such as a German bank. Acting through a suitably located branch will not side-step the tax, although using a subsidiary might. An FTT zone headquartered bank may therefore consider whether it might be helpful to subsidiarise its operations outside the FTT zone. Similarly, a FTT zone branch of a third country financial institution, such as an Italian branch of a US bank, will be caught in respect of its branch operations.

An entity legally established in the FTT zone will be subject to the FTT even if its tax residence is elsewhere.

**A financial institution that has regulatory authority to operate in the FTT zone from abroad.**

Under the revised proposal, a financial institution that operates in a participating Member State from outside the FTT zone will be treated as established in a participating Member State in respect of transactions operated in the participating Member State. This will apply to all financial institutions resident in a jurisdiction other than a participating Member State, such as financial institutions in third countries (as was the intention of the original proposal) and financial institutions in other non-participating Member States (which was not envisaged by the original proposal).

**A financial institution transacting with an entity with presence in the FTT zone.**

A financial institution that transacts with an entity (whether or not a financial institution) which has a legal or physical presence in the FTT zone or that has authority to operate there falls within the scope of the FTT. This has the effect of dramatically extending the nexus of the FTT and is referred to as the “residence principle”. It is designed to stop relocation of activities from the FTT zone. For example, in theory, a party in the FTT zone will be in no different position whether it transacts with a party in the FTT zone or outside the zone. In either case, its counterparty will be subject to the FTT (which may be passed on to the FTT zone entity). However, this is an FTT zone-centric perspective. Another way of looking at the residence principle is that it may cause some financial intermediary services to relocate from the FTT zone unless an exemption applies. This is because the intermediary’s presence in the FTT zone would cause its client to be subject to the FTT if it is party to a transaction with its client. This would not occur if it used an intermediary
outside the FTT zone – it may be subject to the FTT for other reasons (the issuance principle) but the location of the intermediary would be decisive. Take the example of a Belgian broker acting as principal for a US client selling Irish shares to a Swiss company. The US client could be deemed to be established in Belgium and be subject to Belgian FTT on the sale of the shares because it has a Belgian broker (unless an exemption applies). This would not be the case if the US client used a broker in the UK. Although there is an exemption in cases where there is no link between the economic substance of the transaction and the FTT zone, it is not clear how far this exemption can be applied and whether it will help a broker in this type of case (see page 12 under Exemptions).

This also applies where the financial institution is acting as agent for a person within the FTT zone.

A financial institution engaged in a transaction in respect of an instrument issued by an FTT entity.

Any financial institution, wherever located and with whomever it transacts, will fall within the scope of the FTT regarding transactions in respect of an instrument issued by an entity incorporated or registered in the FTT zone. In other words, the FTT would apply where there is a sale of bonds issued by a French company between an Australian bank and a Chinese bank. This is the most significant change in the revised proposal because of its wide extension to the scope of the FTT. It is referred to as the “issuance principle” and was introduced in order to improve the resilience of the FTT system against relocation. Essentially, it applies where none of the parties to the transaction is established in the FTT zone and the transaction would not otherwise be within the scope of the FTT.

The issuance principle applies to a financial transaction in almost all financial instruments. It applies to transferable securities (such as shares and bonds), money-market instruments, units in collective investment undertakings and structured products. Instruments which are excluded are derivative agreements that are not traded on an organised platform. This indicates that a transaction in a derivative agreement which is traded over an exchange could be within the scope of the issuance principle where a party to the derivative agreement is located (or deemed to be located) in the FTT zone.

The drafting currently refers to a derivative agreement “issued” by a person that is incorporated or registered in a participating Member State, but the reference to “issued” does not rest easily with the concept of derivative agreements, which are “entered into” instead of issued. Proposed amendments to the Markets in Financial Instruments Directive will result in standardised derivatives being traded over exchanges and result in increasing numbers of derivative contracts coming within the scope of the issuance principle.
**Exemptions**

Exemptions include:

**Primary market transactions**

Primary market transactions are excluded. In a change to the original proposal, this has been extended to apply to units in UCITS and alternative investment funds in order to comply with the Capital Duty Directive. Helpfully, the exclusion has been clarified so that it includes the activity of underwriting and subsequent allocation of financial instruments in the framework of their issue. This recognises (no doubt) that investment in an issuer on a capital raising involves more than just the issuance of bonds.

Redemption of shares and units are still subject to the FTT.

**Spot currency and physical commodity transactions**

Although spot currency and physical commodity transactions are excluded, derivatives contracts based on currency transactions are included.

**Provision of credit and insurance transactions**

Provision of credit and insurance transactions are not within the scope of the FTT in any event.

**A transaction where there is no link between the economic substance of the transaction and the FTT zone**

A transaction where there is no link between the economic substance of the transaction and the FTT zone is exempt from FTT. The Belgian broker acting as principal for a US client selling Irish shares to a Swiss company mentioned above might try to rely on this exemption. However, as was mentioned before, it is not clear how far this exemption can be applied and whether it will help this broker. A difficulty with this exemption is that the Commission’s examples of where it may apply are situations with a very remote connection to the FTT zone, so we have not had any real comfort about its value yet and there is a question mark over its application. Only time will tell.
A financial institution that acts in the name of, or for the account of, another financial institution.

If a financial institution acts in the name of, or for the account of, another financial institution only the latter financial institution is liable to pay FTT (the disclosed client provision). However, there are significant limitations to this exclusion. It is in no way a general market maker exemption such as the ones found in French FTT or UK stamp duty reserve tax (SDRT) and does not apply where the financial institution is acting as principal. Consequently, the simple sale of securities over an exchange could result in an effective tax rate of 0.8% to 1.0%. For instance, a sale of equities from seller to seller’s broker, clearing member, central counterparty, clearing member, buyer’s broker and then buyer could lead to up to ten charges if all parties act as principal and both the seller and buyer are financial institutions. This would give a 1% effective tax rate, rather than 0.2% (for just the buyer and seller). The ten charges would arise from one charge on both the seller and buyer and two separate charges (on the buy and the sell side) by the brokers and clearing members. Only the central counterparty is exempt. Although the original proposal received considerable criticism for this cascading effect, there has been no relaxation of it in the revised proposal. Indeed, the Impact Assessment issued with the revised proposal notes that to do otherwise would lead to a significant negative impact on the tax yield. It seems to be assuming that brokers, for instance, may simply change behaviour and buy and sell in the name of the other financial institutions rather than in their own name and for their own account. It is expected that any FTT costs will be passed on to the end-investor given the small margins of the participants in the sale chain.

Central counterparties, central securities depositaries and international central securities depositaries

Although central counterparties, central securities depositaries and international central securities depositaries are excluded from the primary charge to the FTT (where they are not performing functions which could be considered as trading activities), they could have a secondary liability to the FTT. This was not clear in the original proposal, but has been put beyond doubt in the revised proposal and will apply where the party with the primary liability does not pay the tax on time (see also page 15, How will the tax be collected?).

Transactions with certain international organisations or bodies

Transactions with certain international organisations or bodies such as central banks of Member States, the European Central Bank, the European Financial Stability Facility and the European Stability Mechanism are excluded. Central banks of non-EU Member States are not excluded, although those of the 16 non-participating Member States are.

Transactions with the EU itself

Transactions with the EU itself are excluded. This applies where the EU exercises the function of management of its assets, of balance of payment loans and of similar activities.
Transactions carried out as part of restructuring operations protected from charge by article 4 of the Capital Duty Directive

Transactions carried out as part of restructuring operations protected from charge by article 4 of the Capital Duty Directive are excluded. This is another attempt to try to make the FTT Directive compliant with this Directive.

Any other transactions which are protected under the Capital Duty Directive

Just in case the revised Directive does not deal with all possible conflict with the Capital Duty Directive, there is a general provision allowing the Capital Duty Directive to take precedence over the revised Directive. This is necessary because the Capital Duty Directive involves all 27 Member States and the FTT proposal involves just 11 of them.

GAPS IN THE EXEMPTIONS

It is notable that there is no exclusion for pension funds, despite the fact that Germany is understood to favour this, as do other Member States. For example a pension funds exclusion is a condition for the Netherlands joining the 11 Member States participating in the ECP.

There is also no general exclusion for intra-group transactions. This is the case whatever the transaction, whether it is, eg a transfer of securities or an intra-group hedge. The new exclusion for restructuring operations protected from charge by article 4 of the Capital Duty Directive will be of limited help to group transfers.

GENERAL ANTI-ABUSE RULE

The revised proposal contains a general anti-abuse rule aimed at an artificial arrangement (or series of arrangements) lacking commercial substance and with the essential purpose of avoiding the FTT contrary to the object, spirit and purpose of the regime. Where the FTT would otherwise have been avoided, participating Member States should assess the tax according to the economic substance of the transaction. There is specific drafting addressing the use of depositary receipts where the underlying security is issued in a participating Member State. The presumption is that the use of depositary receipt arrangements will be caught by this provision unless it can be shown that the depositary receipt arrangement would have gone ahead regardless of the FTT regime. US investors may be relieved at the targeted nature of the anti-abuse rules relating to the use of depositary receipts.
WHAT IS THE RATE OF FTT AND WHAT IS THE TAXABLE BASE?

The minimum rates to be set by participating Member States are set out in the table below.

<table>
<thead>
<tr>
<th>Rate</th>
<th>Taxable Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.01%</td>
<td>Notional amount referred to in the contract</td>
</tr>
<tr>
<td>0.1%</td>
<td>Consideration or (in some cases) market value</td>
</tr>
</tbody>
</table>

It is notable that the tax base for derivatives is the notional amount, which is likely to be a relatively high amount. Significantly, there is no distinction between a one week cross currency swap and a one year cross currency swap with the same notional amount. The same charge would apply to either, but the pricing for the client would be very different. The result could be that derivatives which are very liquid, such as the one week cross currency swap, are no longer used. Alternatively, there could be a relocation of some high-volume/low-margin transactions out of the FTT zone. Having said that, this seems to be the intention of the proposal. A stated objective of the FTT is to limit undesirable market behaviour and thereby stabilise markets.

Unfortunately, this means that the Commission has not made a distinction between parties entering into derivatives to hedge risk (which would have a stabilising, and therefore beneficial, effect on business) and trading in highly liquid derivative instruments (which is seen by the Commission as undesirable).

HOW WILL THE TAX BE COLLECTED?

It is expected that entities such as central counterparties, central securities depositaries and international central securities depositaries (eg Euroclear) will have a significant role in the collection of the tax in practice because of their secondary liability to pay the tax if it is not paid by their counterparty on time. This is reinforced by the fact that the due date for payment is immediate for electronic trading. It is therefore anticipated that the FTT would be levied at the point when the financial transaction occurs and that the central counterparty or depositary will collect the FTT automatically (ie as is currently the case for the UK’s SDRT, collected through CREST). These entities will want to find a mechanism to ensure that their counterparties bear the tax which they collect on their behalf through various mechanisms, eg making deductions from payments (if possible).

The central counterparties, central securities depositaries and international central securities depositaries will have to be registered for the FTT and file monthly tax returns. This is likely to result in large compliance costs for the central counterparties.

1 Where settlement of a derivative contract involves a related transfer of financial instruments (eg a transfer of shares as collateral), the related transfer will be subject to FTT at the higher rate of 0.1%.
and depositaries. They will need to invest in systems which will ensure that they can identify relevant transactions and ensure that they have information about the position before net settlement of a transaction, which may be easier said than done. They also need to make sure that the FTT gets paid to the correct participating Member State. The role as collecting agent for the FTT applies to central counterparties, central securities depositaries and international central securities depositaries whether or not they are located in the FTT zone.

Of course, it will not always be the case that a financial transaction is conducted over an exchange. Where this is the case, the tax will become due within three working days. This seems an unrealistically short time. In relation to transactions that are not conducted over exchanges there is the problem of collection where the parties are not located in the FTT zone. Take the example of a sale of Italian bonds between two Cayman hedge funds, which would result in an FTT charge under the issuance principle. The revised proposal requires the two hedge funds to register for the FTT, keep transaction data and pay the FTT. A key element of the regime is the incidence of a secondary tax liability if a party’s counterparty does not pay on time. The normal commercial relationship between the two parties is intended to incentivise payment, but will this work in all cases where neither party is easily within the grasp of the tax collector?

It is notable that the Commission has reserved for itself the power to adopt implementing acts providing for uniform collection of the FTT. It also asks participating Member States to consider whether the arrangements for collection under the proposal could be supplemented in their jurisdiction with further mechanisms that would involve collecting tax from persons who are not party to the transaction. The Impact Assessment suggests that an individual Member State should consider which mechanism works best for it based upon its organisation or markets and infrastructure.

**TIMING**

The Commission wants the tax to be charged from 1 January 2014, with participating Member States adopting local rules to implement the FTT by 30 September 2013. This timing looks to be very challenging indeed. If it is to be achieved, participating Member States will need to deal quickly with contentious issues such as the fact that pension funds are not excluded. The time frame, if it can be believed, leaves limited time for lobbying for further changes to the scope and drafting of the FTT.
HOW WILL IT IMPACT ON PARTICIPATING MEMBER STATES?

Those participating Member States that already have a financial transaction tax (see Part III) will need to replace their local tax with the new harmonised tax. Although the FTT should lead to the repeal of local financial transaction taxes, the measure should not impact on the bank levies of the participating Member States.

The European Commission advocates that part of the FTT receipts shall constitute an own resource for the EU budget. The gross national income based resource drawn from the participating Member States would be reduced accordingly. Preliminary estimates indicate that revenues from the tax could be around EUR 31 billion on a yearly basis, depending on market reactions and any relocation of transactions. Although there are measures in the revised Directive designed to avoid relocations, they would not stop every kind of financial transaction being relocated, eg where the financial instrument being traded has not been issued by an entity in the FTT zone.

The most significant type of relocation is likely to be in relation to derivatives activity. When the Commission assessed the impact on a tax amongst all 27 Member States, it predicted that could be up to a 70%-90% reduction in derivatives transactions within the EU.

There may be a drop in liquidity in financial markets in the FTT zone.

There may also be attempts to relocate activities of entities of participating Member States to subsidiaries based outside the FTT zone, eg financing and treasury activities. Although, the general anti-abuse rule would need to be considered. Any additional anti-avoidance provisions which may be implemented by participating Member States would also be relevant.

Some financial transactions carried out in the FTT zone, eg high-volume/low-margin derivative trades, may become uneconomic, which is a desired outcome of the Commission.

Cost of raising funds for FTT zone institutions will increase.

HOW WILL IT IMPACT ON OTHER JURISDICTIONS?

Jurisdictions outside the FTT zone could benefit from relocation of activities out of the FTT zone.

However, financial institutions outside the FTT zone cannot escape the FTT unless they only transact with each other, avoid trading platforms in the FTT zone and do not transact in FTT zone instruments.

The residence principle will have a significant impact on financial institutions located in non-participating Member States as well as those located outside the EU. For example, a US bank entering into a financial transaction with a German counterparty would be subject to the FTT (assessable by Germany). In this regard, it is worth noting that the
US Treasury is reported as having voiced concerns about the tax, so it will be interesting to see how and whether the US responds more formally to the proposals.

The revised Directive has a number of measures in place to ensure that the FTT is collected where the residence principle applies. If the FTT is not collected by an exchange, it is still likely that the US bank (referred to above) will pay or bear the tax, either because of commercial reasons or a contractual indemnity. This is because if it did not pay, the German counterparty would become secondarily liable for the US bank's FTT. Parties that could be secondarily liable for the FTT will want to include suitable contractual provisions for its recovery, or for it to be taken into account in the pricing of its activities.

There is an obvious question of whether there is a difference between different areas outside the FTT zone: the rest of the EU and the rest of the world. As regards the situation where tax is not collected automatically by an exchange, the party outside the FTT zone is not intending to pay the tax, and it is not possible to collect the tax from a counterparty within the FTT zone by way of secondary liability (eg it is insolvent or the issuance principle applies), there is a potential difference. This is because of the Mutual Assistance Directive for the Recovery of Taxes, which enables Member States to ask for the assistance of other Member States in the collection of their taxes, including the FTT. However, it remains to be seen how effective the Mutual Assistance Directive would be to enforce the FTT cross border and whether non-participating Member States will give high priority to recovering the FTT of other Member States.

As discussed in Part III, other non FTT zone jurisdictions will have their own taxes similar to the FTT, such as the UK's SDRT. It follows that there is scope for double taxation, eg a sale of shares in a UK incorporated company by a Spanish financial institution would attract both SDRT and the FTT (assessable by Spain). Will this issue be addressed by double taxation agreements?

The result will be taxation on the financial institutions of other jurisdictions without those jurisdictions benefiting from the tax revenues.

**NEX T STEPS**

The next steps are negotiation of the proposal by the participating Member States. Non-participating Member States will be part of the discussions, but they will not have a vote once the scope of the FTT is finalised. Once this stage is reached participating Member States will have to vote for the FTT on a unanimous basis.

It will be interesting to see if any of the 11 Member States involved lobby for a narrow equities-based tax, with a small element of taxation on derivatives.
Part II

Is the FTT legal?
Increasingly, the question is being asked whether the FTT is legal within the context of the EU.

To be legal the FTT must meet the conditions for the use of the ECP as set out in the EU Treaties. It is questionable whether these conditions are satisfied. Also, there is an argument that the FTT could be contrary to EU law because it infringes the fundamental freedoms found in the Treaty on the Functioning of the European Union (TFEU).

**ECP CONDITIONS**

Essentially, the ECP conditions require that:

a) The use of ECP is a last resort.

b) Nine Member States participate in it.

c) The ECP measure will reinforce the integration of the whole EU.

d) The measures shall not undermine the internal market, constitute a barrier to, or discrimination in, trade between the Member States, nor shall it distort competition between them.

e) It shall respect the competencies, rights and obligations of those Member States that do not participate in it.

The Commission’s arguments in support of its claim that the FTT is legal can be summed up as follows:

a) The ECP is a last resort – a 27 Member State solution was rejected.

b) Currently, 11 Member States are participating in the ECP.

c) The integration within the EU will be reinforced as it will be easier for financial operators from outside the FTT zone to deal with just one type of FTT within the FTT zone.

d) The internal market will not be undermined, as there is already fragmentation of the market by virtue of the coexistence of various forms of FTT, eg the French FTT and the emerging FTIs in the FTT zone. As double taxation or non-taxation may develop if there is no harmonisation, the ECP FTT reduces the potential for distortion of competition.

e) Rather than the FTT impede the rights, competencies and obligations of non-participating Member States, such Member States can have their own tax on financial transactions and are free to join the FTT zone, if they wish, at a later stage.
HOW STRONG ARE THE COMMISSION’S ARGUMENTS?

In relation to reinforcing integration, the Commission has changed its position. Under the original proposal the Commission explained that the proper functioning of the internal market could only be ensured through action at (full) EU level. It is taking a different position now.

It is likely that one of the strongest arguments against satisfaction of the ECP conditions will be in relation to distortion of competition. For instance, if a financial institution within the FTT zone acts as an intermediary for a financial institution outside the FTT zone, its presence in the FTT zone could make its customer subject to the FTT. Take the example of a Belgian broker acting as principal for a US client selling Irish shares to a Swiss company. The US client could be deemed to be established in Belgium and be subject to Belgian FTT on the sale of the shares because it has a Belgian counterparty. If the US client had used a UK broker instead, FTT could have been avoided. This potentially puts financial intermediaries within the FTT zone at a competitive disadvantage to those outside unless it can be argued that the transaction should be excluded from charge because it has no economic nexus to Belgium (which is far from clear). Another example of distortion applies in the context of managing a UCITS fund established in a non-participating Member State. If the manager were established in a participating Member State, it would incur the FTT, whereas this may be avoided if the manager is outside the FTT zone (and assuming connecting factors such as the issuance principle do not apply). This result runs counter to an objective of the UCITS IV Directive, which is to allow management companies located in one Member State to be able to manage a UCITS fund in another Member State. There will be other instances of distortion of competition within the EU.

Also, the Commission’s argument that the FTT is needed to achieve harmonisation of emerging domestic FTTs has its limitations when you consider the substance of those FTTs. They are largely based upon the issuance principle, eg the French and Italian FTTs, and any taxation of derivative contracts is narrowly focused in these regimes. In contrast, the ECP FTT has a broad application to derivative contracts, giving the result that the harmonisation measure extends the scope of the domestic taxes considerably.

Non-participating Member States are advised that they can join the FTT and that this flexibility means that their rights and competencies are preserved. This is a difficult argument for the Commission to make because, arguably, their right and competency is to tax financial transactions as they would see fit (subject to the usual limitations). Indeed the presumption of the ECP condition is that they are not participating, not that they can do so. Significantly, there is scope for double taxation when considering the financial transactions of non-participating Member States, eg a sale of UK shares between two financial institutions established in the FTT zone would attract double (if not triple) taxation by virtue of two incidences of the FTT and UK SDRT. The UK is advised that it can avoid double taxation by joining the ECP (and presumably repealing SDRT), but this disregards the fact that the FTT has been rejected by the UK. Another route could be to avoid double taxation under a tax treaty, but which Member State would collect the tax?
Would it be the UK or a Member State in the FTT zone? If the UK gives up its taxing right to avoid double taxation, is there a restriction on its right and competency to raise tax on financial transactions? These are difficult questions that are not adequately addressed by the Commission’s papers so far.

A further question is whether the inclusion of the issuance principle can invalidate the use of ECP. In other words, to what extent should the measure, considered by the 11 Member States under the ECP, be the same as the measure rejected at the 27 level? The Treaty says that ECP can be used once it is established that the objectives of the measure proposed at the 27 level cannot be attained. This indicates that there has to be some connection between the measure rejected by the 27 Member States and the measure considered by the 11 Member States. However, the issuance principle extends the scope of the tax considerably. Also, although it is justified as an anti-avoidance measure, to deter relocation of transactions which would otherwise have been caught by the tax under the original principle, the issuance principle goes beyond that. It extends the scope of the tax under the original proposal in order to deter avoidance, which must make it an unusual anti-avoidance measure. Most avoidance measures disapply a treatment that would otherwise apply where avoidance exists.

**IS THE FTT CONTRARY TO THE TFEU FUNDAMENTAL FREEDOMS?**

An obvious question is whether the FTT would undermine the freedom of movement of capital, which applies to cross-border movements of capital with third countries as well as cross-border movements within the EU. Consequently, this will be of interest to financial institutions located outside the EU as well as those in non-participating Member States.

Relevant questions are:

a) Is there access to the Treaty?

b) Is there a breach of the Treaty freedoms (eg discrimination or does the FTT restrict the free movement of capital)? (Challenges under other fundamental freedoms are outside the scope of this brochure.)

c) If the FTT forms a restriction, can it be justified?

d) If it can be justified, is the FTT suitable to protect the public interest involved?

e) If there is a justification for the restriction, is the measure proportional in its restrictive effects in relation to the legitimate aim which is pursued?

In order to rely on the Treaty freedoms, there has to be a cross-border element. Therefore, the Treaty freedoms cannot be used to challenge an FTT which is levied on a purely domestic transaction (eg two German counterparties selling a German bond).

If there is a cross-border element, the next question is whether the measure is discriminatory or restricts the Treaty freedoms. Discriminatory measures are forbidden, but
the FTT is not discriminatory. The important question is, however, whether the FTT restricts the fundamental freedoms. It is worth starting with the transaction which the Commission itself considers would be a breach of the freedom of movement of capital – spot currency transactions. These are excluded from the scope of the FTT because charging the FTT on spot currency transactions would make such transactions more costly and there would therefore be a restriction. However, there is a question of whether the exclusion for spot currency transactions goes far enough. Should it extend to a currency forward, other currency derivatives or anything else? Case law suggests that the ‘movement of capital’ would include those capital movements listed in the nomenclature of the former Directive 88/361/EEC. It is significant that the nomenclature extends to derivative transactions as well as investments (noting the exclusion for primary market transactions in the FTT proposal). Various transactions which may be ancillary to the issue of shares and debt securities are referred to in the nomenclature, such as forward transactions, transactions carrying an option or warrant and swaps against other assets.

If there is a restriction, the FTT is still legal if there is a justification for the restriction. There are specific legislative grounds for justifying a restriction on the free movement of capital, but the Commission may find it challenging to fall within them. For instance, there is a public policy exclusion, but the Court of Justice of the European Union (CJEU) case law sets a high bar for relying on this exclusion. Instead, the Commission may seek to justify the FTT under the ‘rule of reason’, which is a case law concept. In approaching the rule of reason, in the context of the FTT, there are a number of uncertainties. One is whether the rule of reason can apply to a partial harmonisation measure under the ECP.

However, even if the rule of reason applies and the restriction is justified, it still has to be suitable and proportional.

**WHO CAN BRING A CHALLENGE?**

Member States are able to challenge the legality of the FTT directly in the CJEU, but this claim is time limited. Broadly, they have two months after publication of the measure to mount their challenge. The right of direct challenge does not extend similarly to other jurisdictions. There are indications that Luxembourg may be willing to make a challenge given its extra-territorial impact on non-participating Member States.

Financial institutions subject to the tax could also make a claim in a local court (eg the court of a participating Member State) which could make its way to the CJEU, as is the case with usual legal challenges on questions of EU law. These claims are not time-limited and it would be far easier for a financial institution to make a claim on this basis rather than make a direct claim to the CJEU.
WHAT ARE THE CHANCES OF SUCCESS?

There is very little case law authority on challenges to the use of the ECP. There is only one pending joint case which looks at whether the ECP conditions are satisfied and it is not a particularly helpful case for a potential claimant (the combined cases Kingdom of Spain (C-274/11) and Italian Republic (C-295/11) v Council of the European Union). However, some may want to view it with caution. It is just an Advocate General’s opinion and we are still awaiting the CJEU decision. Also, others might try to distinguish the case. Significantly, the challenge in that case did not extend to a breach of a fundamental freedom.

Despite the chance of success of any claim being uncertain (particularly given the novelty of using the ECP and the scarcity of authority on such claims) it is likely that claims will emerge. There is a lot of tax at stake. Financial institutions will be very interested in whether non-participating Member States themselves pursue claims.
Part III

Impact in particular jurisdictions
What is the General Attitude of Belgium vis-à-vis a Financial Transaction Tax at EU Level Including the Proposed FTT Directive?

Already in 2004, Belgium had approved the introduction of a “Tobin” tax, but the entry into force was dependent on the introduction of the same tax in the entire EU. Although the Belgian Tobin tax was only aimed at spot currency transactions, which are exempt under the proposed FTT Directive, the Belgian Government has decided to participate in the FTT by means of enhanced cooperation, without any public debate. The Belgian Minister of Finance has recently commented though that he hopes that more Member States (and in particular the Netherlands and Luxembourg) will participate as well, due to the risk of relocation of businesses.

While Waiting for a Potential Implementation of the Proposed FTT Directive, Has Belgium Introduced, or Is It Planning to Introduce, a Domestic Financial Transaction Tax? If Yes, What are the Main Features of Such Tax and How Do They Compare with the Proposed FTT Directive? Also, Would Any Such Domestic Legislation Be Eliminated as Soon as the Proposed FTT Directive Has Entered Into Force?

Belgium currently applies a transfer tax on transactions in tradable securities executed through a Belgian financial intermediary, but the scope is limited: given the large number of exemptions (in particular for non-residents and institutional investors), this Belgian transfer tax is in fact only payable by Belgian retail investors. The Belgian transfer tax is not due on derivatives, on the basis that the derivatives do not classify as tradable securities, but this position is now being challenged by the tax authorities.

At present, there are no plans to introduce a domestic FTT along the lines of the proposed FTT Directive.
France

WHAT IS THE GENERAL ATTITUDE OF FRANCE VIS-À-VIS A FINANCIAL TRANSACTION TAX AT EU LEVEL INCLUDING THE PROPOSED FTT DIRECTIVE?

France has been one of the main advocates for the implementation of a global financial transaction tax. Back in November 2011, at the G20 summit, former French President Nicolas Sarkozy had already called for a tax on financial transactions that would curb financial speculation and force markets to help pay for government efforts to rescue debt-ridden economies. At the EU level, France has been pressing other countries on creating a financial transaction tax that would apply in the Eurozone and when Nicolas Sarkozy announced in February 2012 that he was planning to introduce a 0.1% financial transaction tax in France, he said that he was doing so in the hope that other European Union nations would follow suit amid lingering divisions within the 27-member bloc over such a measure: “What we want to do is to provoke a shock, to set an example” said Nicolas Sarkozy.

After the presidential election of May 2012, newly elected President François Hollande, who as a candidate had also pledged to impose a tax on financial transactions, continued to support the implementation of a FTT at the EU level.

WHILE WAITING FOR A POTENTIAL IMPLEMENTATION OF THE PROPOSED FTT DIRECTIVE, HAS FRANCE INTRODUCED, OR IS IT PLANNING TO INTRODUCE, A DOMESTIC FINANCIAL TRANSACTION TAX (OR A SIMILAR TAX, STAMP DUTY, ETC)? IF YES, WHAT ARE THE MAIN FEATURES OF SUCH TAX AND HOW DO THEY COMPARE WITH THE PROPOSED FTT DIRECTIVE? ALSO, WOULD ANY SUCH DOMESTIC LEGISLATION BE ELIMINATED AS SOON AS THE PROPOSED FTT DIRECTIVE HAS ENTERED INTO FORCE?

On March 2012, France adopted a package of three financial taxes, including a tax on high frequency stock orders, a tax on unhedged credit default swaps on sovereign bonds and a more conventional financial transactions tax on acquisitions of French shares (the French FTT).
The French FTT has a much more limited scope than the proposed European FTT. As mentioned above, the rationale for the French FTT was to take the lead and to set up a tax on financial transactions at a domestic level as a temporary measure until a European FTT is introduced. The French Government was concerned that implementing a French FTT with a wider scope would provoke the relocation of financial transactions outside France and more generally cause damage to the French economy. In particular, bonds were not included within the scope of the French FTT as the Government was concerned that this would adversely affect the ability of French companies to obtain financing.

The French FTT has been applicable since 1 August 2012 at a rate of 0.2% on acquisitions of French shares or certain assimilated securities (ie shares and other securities giving access to the capital or voting rights of the issuer, whether issued under French or non-French law, including ADRs as from 1 December 2012) listed on a regulated market, where the relevant issuer’s stock market capitalisation exceeds EUR1 billion (on 1 December of the calendar year preceding the acquisition). Contrary to the proposed EU FTT, the French FTT does not apply to all kind of financial transactions and for instance it does not apply to the acquisition of plain vanilla bonds, or units in UCITS nor to the conclusion of derivative contracts.

The French FTT is payable by the investment service provider or broker executing the purchase order or, in the absence of such an investment service provider/broker, by the custodian holding the shares for the purchaser. In circumstances where the shares are delivered in the books of a client of a member of Euroclear France (ie investment service provider/broker/custodian going through a member of Euroclear France) the reporting/disclosure is made by the member to Euroclear France. The French FTT is effectively paid in most cases by Euroclear France to the French tax authorities. In principle, the French FTT applies only once in respect of a single transaction (although there may be several intermediaries), and there is generally no cascade effect comparable to that expected under the proposed EU legislation.

French law provides for a number of exemptions from the French FTT (which are more extensive than the exemptions described in the proposed EU legislation):

(i) primary issuance of equities (ie buying shares from the issuer in connection with a share capital increase);

(ii) certain transactions realised by a clearing house or central securities depositary;

(iii) acquisitions by French or non-French financial institutions in the course of their market-making activities, this exemption being significantly used by counterparties;

(iv) certain transactions realised for the account of issuers in order to provide liquidity in accordance with market practice and EU legislation;

(v) intra-group dealings and certain qualifying reorganisations;
(vi) temporary transfers of securities (e.g., stock loans and repurchase transactions);

(vii) acquisitions of securities by employee funds and acquisitions made by employees through their employee savings plans;

(viii) shares buy-backs if the shares repurchased by the issuer are sold to its employees through an employee savings plan; and

(ix) acquisitions of bonds exchangeable or convertible into shares.

It is important to note that even exempt transactions must be reported to the French tax authorities (except the exchangeable and convertible bonds).

During the first five months of application, the French FTT collected by the French tax authorities amounts to circa EUR 199 million.
WHAT IS THE GENERAL ATTITUDE OF GERMANY VIS-À-VIS A FINANCIAL TRANSACTION TAX AT EU LEVEL INCLUDING THE PROPOSED FTT DIRECTIVE?

Germany has favoured the introduction of an FTT for a number of years. However, for a long time the prevailing view was that this should only be introduced on a worldwide or at least EU-wide basis. It was only in the summer of 2012 that Germany endorsed the proposal to introduce an FTT for a smaller group of countries within the EU by means of enhanced cooperation. This is due to the fact that the government needed the support of the opposition parties to enact the Treaty on Stability, Coordination and Governance and the European Stability Mechanism (ESM). In order to obtain this support the government agreed to promoting an FTT for a smaller number of countries within the EU. Today, Germany together with France is one of the main drivers behind the proposed FTT and the FTT zone.

WHILE WAITING FOR A POTENTIAL IMPLEMENTATION OF THE PROPOSED FTT DIRECTIVE, HAS GERMANY INTRODUCED, OR IS IT PLANNING TO INTRODUCE, A DOMESTIC FINANCIAL TRANSACTION TAX? IF YES, WHAT ARE THE MAIN FEATURES OF SUCH TAX AND HOW DO THEY COMPARE WITH THE PROPOSED FTT DIRECTIVE? ALSO, WOULD ANY SUCH DOMESTIC LEGISLATION BE ELIMINATED AS SOON AS THE PROPOSED FTT DIRECTIVE HAS ENTERED INTO FORCE?

At present, Germany does not have an FTT or stamp tax on transactions in securities or derivatives. Germany had a transfer tax for securities transactions in place but this was repealed in 1990. At present, there are no plans to introduce a domestic FTT in Germany. The policy is rather to progress the proposed FTT Directive for the FTT Zone.
Italy

WHAT IS THE GENERAL ATTITUDE OF ITALY VIS-À-VIS A FINANCIAL TRANSACTION TAX AT EU LEVEL, INCLUDING THE PROPOSED FTT DIRECTIVE?

Since January 2012, Italy has supported the introduction of the financial transaction tax at an EU level (which had been opposed by the previous government) asking for a European standpoint which all the countries will work towards.

Italy is now included in the list of 11 Member States which have been authorised to proceed with the introduction of a financial transactions tax though enhanced cooperation, during the last meeting of EU finance ministers (ECOFIN) on 22 January and 14 February 2013.

WHILE WAITING FOR A POTENTIAL IMPLEMENTATION OF THE PROPOSED FTT DIRECTIVE, HAS ITALY INTRODUCED, OR IS IT PLANNING TO INTRODUCE, A DOMESTIC FINANCIAL TRANSACTION TAX? IF YES, WHAT ARE THE MAIN FEATURES OF SUCH TAX AND HOW DO THEY COMPARE WITH THE PROPOSED FTT DIRECTIVE? ALSO, WOULD ANY SUCH DOMESTIC LEGISLATION BE ELIMINATED AS SOON AS THE PROPOSED FTT DIRECTIVE HAS ENTERED INTO FORCE?

On 24 December 2012, the Italian Parliament approved the Italian budget legislation, which introduced the Italian financial transaction tax.

1. As of 1 March 2013, the transfer of property rights on (i) shares and other participating securities issued by Italian resident companies and (ii) financial instruments representing shares and participating securities will be subject to an FTT at the rate of:

   - 0.22% (for 2013 only) and 0.2% (as of 2014) for over-the-counter transactions; and
   - 0.12% (for 2013 only) and 0.1% (as of 2014) for trades executed on a regulated market or multilateral trading system.
The FTT is levied on a basis equal to (i) the value resulting from the net balance of daily trades on the same security; or (ii) the consideration paid for each trade and it is payable by the purchaser and does not apply to subjects interposed in the relevant transaction.

The FTT does not apply to: (a) new issuances of shares, including upon conversion of bonds; (b) transfers by way of inheritance or gift; (c) repos and securities lending; or (d) transfers of shares issued by companies with an average market capitalisation, in November of the year preceding the sale, which was lower than EUR500 million.

2. With effect from 1 July 2013, the FTT also applies to transactions concerning derivative contracts on the relevant instruments at fixed rates, varying depending on the type of derivative and its notional value, up to €200 (per party) for transactions exceeding €1 million for over-the-counter derivatives and a reduced rate of 20% of the ordinary fixed rate on a conventional tax base (to be indicated in a Ministerial Decree) for derivatives executed on a regulated market or multilateral trading system.

3. A 0.02% FTT is also applied to high-frequency trading.

In all the above cases, the FTT does not apply to:

(i) entities which carry on market-making activities as defined in article 2(1)(k) of EU Regulation No. 236/2012 of 14 March 2012; (ii) entities acting on behalf of the issuer to support the liquidity of the issuer's shares in accordance with EU Directive 2003/6/CE of the European Parliament and Council and Directive 2004/72/CE of the European Commission; (iii) Italian mandatory pension funds and other pension funds as provided for by Legislative Decree No. 252 of 5 December 2005; (iv) transactions between related parties pursuant to Article 2359, para (1) (no. 1 and 2) and para 2 of the Italian Civil Code, or in connection with reorganisations meeting the requirements to be determined by a Ministerial Decree; or (v) trades in ethical financial products and services as defined by Article 117-ter of the Italian Finance Act.

The FTT applies regardless of where the transaction is entered into and the tax residence of the parties. The FTT is levied and paid by the banks, fiduciary companies, investment companies and by other subjects involved in the trading activities, including non-resident financial intermediaries. The intermediary may suspend the transaction if the FTT is not funded by the client. In presence of more intermediaries, the FTT is payable by the entity receiving direct orders from the client.

Non-resident intermediaries are entitled to appoint a fiscal representative who will be jointly and severally liable with the non-resident intermediary.

The FTT is to be paid by the 16th day of the month following the month in which the transaction is executed and a Decree of the Ministry of Economy and Finance (currently only available in draft) will set out the implementation rules and reporting obligations. Other requirements relating to the FTT may be provided for by measures to be adopted by the Revenue Agency.

Italian FTT could be significantly amended in the light of the approval of the EU Directive.
WHAT IS THE GENERAL ATTITUDE OF LUXEMBOURG VIS-À-VIS A FINANCIAL TRANSACTION TAX AT EU LEVEL INCLUDING THE PROPOSED FTT DIRECTIVE?

Luxembourg has claimed on numerous occasions to be in favour of the FTT provided it were to be introduced on a global level to avoid any delocalisation of activities from the European Union to offshore financial centres. However, in a statement issued on the 22 January 2013, after the European Council Decision authorising enhanced cooperation in the area of a FTT Directive, the Luxembourg Administration has indicated that it would not stand in the way of Member States that would wish to introduce such a tax among them by enhanced cooperation if the conditions of the treaty were fulfilled. Luxembourg still has strong concerns regarding the potential implications for non-participating Member States of a future FTT. Luxembourg calls on participating Member States to respect the Treaty provisions and ensure that the potential impact of future tax introduced among them will not spill over to non-participating Member States.

WHILE WAITING FOR A POTENTIAL IMPLEMENTATION OF THE PROPOSED FTT DIRECTIVE, HAS LUXEMBOURG INTRODUCED, OR IS IT PLANNING TO INTRODUCE, A DOMESTIC FINANCIAL TRANSACTION TAX (OR A SIMILAR TAX, STAMP DUTY ETC)? IF YES, WHAT ARE THE MAIN FEATURES OF SUCH TAX AND HOW DO THEY COMPARE WITH THE PROPOSED FTT DIRECTIVE? ALSO, WOULD ANY SUCH DOMESTIC LEGISLATION BE ELIMINATED AS SOON AS THE PROPOSED FTT DIRECTIVE HAS ENTERED INTO FORCE?

At present, there are no discussions to introduce a domestic FTT in Luxembourg.
WHAT IS THE GENERAL ATTITUDE OF THE NETHERLANDS VIS-À-VIS A FINANCIAL TRANSACTION TAX AT EU LEVEL INCLUDING THE PROPOSED FTT DIRECTIVE?

At first, the Dutch government was against the FTT. The government supports the objectives of the FTT, ie to ensure that the financial sector makes a fair and substantial contribution to public finances to recoup the costs of the crisis and to discourage risky market behaviour, but the FTT was not regarded as an efficient instrument to achieve these objectives. Furthermore, it was regarded as not contributing to financial stability. The Dutch government wanted the European Commission to investigate alternatives which lead to less distortion of the market, such as a Financial Activity Tax, a European Bank levy or a Stamp Duty based on the UK stamp duty. Furthermore, the Dutch government opposed the proposal of the European Commission that part of the revenue of the FTT would go directly to the EU budget.

After the Liberal Party and the Social Democratic Party formed a new government in October 2012, the Netherlands changed its view. The Netherlands announced that it would join the FTT enhanced cooperation if certain conditions were met. These conditions are that Dutch pension funds will be exempt from the FTT, that there is not a disproportionate overlap with the current Bank Tax and that the FTT revenue will be returned to the Member States and will not become a new resource for the EU.

As the revised proposal of 14 February 2013 does not exempt pension funds, the Netherlands will not join the current proposed FTT. The Dutch Ministry of Finance is disappointed by the revised proposal, however it has not completely turned its back on the FTT. The Ministry announced that it would fight to get a different kind of tax which would meet the Dutch requirements.
While waiting for a potential implementation of the proposed FTT Directive, has the Netherlands introduced, or is it planning to introduce, a domestic financial transaction tax? If yes, what are the main features of such tax and how do they compare with the proposed FTT Directive? Also, would any such domestic legislation be eliminated as soon as the proposed FTT Directive has entered into force?

On 1 October 2012 the Netherlands introduced a Bank Tax which is similar to the Bank Levy of the United Kingdom. It was introduced for the same reasons as for which the FTT is proposed, except, of course, own resources for the EU budget. However, the Dutch Bank Tax is applied to the balance sheet of a bank, and therefore is not a financial transaction tax. For that reason we will not elaborate on this levy. In order to be subject to the Bank Levy, the balance sheet total of the bank has to exceed EUR 20 billion. As a result of this relatively large threshold only the major Dutch banks will have to pay this Bank Tax. It is unclear whether the Bank Tax would be repealed when the Netherlands adopts the FTT. When the Bank Tax was proposed the idea was that the Bank Tax would be abolished once a European-wide FTT was introduced. However this statement has not been repeated since the FTT proposal was published. The current position is that there should not be a disproportionate overlap between the FTT and the Bank Tax.
Spain

WHAT IS THE GENERAL ATTITUDE OF SPAIN VIS-À-VIS A FINANCIAL TRANSACTION TAX AT EU LEVEL INCLUDING THE PROPOSED FTT DIRECTIVE?

The Spanish Government has clearly favoured the implementation of a common system of FTT at EU level. The Spanish Prime Minister and members of his Cabinet have publicly supported it on various occasions at both national and EU levels. In light of the impossibility of establishing such common system at the level of EU27, Spain forms part of the eleven-Member State group that addressed a formal request to the EU Commission to establish enhanced cooperation between them for the implementation of a common system of FTT.

While waiting for a potential implementation of the proposed FTT Directive, has Spain introduced, or is it planning to introduce, a domestic financial transaction tax (or a similar tax, stamp duty etc)? If yes, what are the main features of such tax and how do they compare with the proposed FTT Directive? Also, would any such domestic legislation be eliminated as soon as the proposed FTT Directive has entered into force?

Spain has not yet introduced a domestic financial transaction tax. Back in October 2012 a draft bill for a law on domestic FTT became public. Although this draft was at a very early stage, it was clear that the Spanish domestic FTT was aimed at being very similar to the French FTT, including (i) a conventional financial transactions tax on acquisitions of Spanish listed shares; (ii) a tax on high frequency stock orders; and (iii) a tax on unhedged credit default swaps on sovereign bonds. It was estimated at that time, according to various sources, that the amount to be collected domestically could be in the region of EUR2,000 million. Bearing in mind the wider scope of the proposed Directive, the potential revenues would clearly exceed this initial estimation.

Now that the Commission has adopted this Decision it seems that the Spanish Government will temporarily set aside its willingness to introduce a domestic FTT in Spain until the EU Directive is finally implemented and the FTT is levied under the ECP as from 1 January 2014. Given that the Spanish Government had the initial plan of introducing the domestic FTT within the first quarter of 2013, it should not be disregarded that they put back on the agenda the implementation of a domestic FTT in Spain should the procedure at EU level be delayed.
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**WHAT IS THE GENERAL ATTITUDE OF THE UK VIS-À-VIS A FINANCIAL TRANSACTION TAX AT EU LEVEL INCLUDING THE PROPOSED FTT DIRECTIVE?**

The UK Government, to put it mildly, has not been in favour of the FTT unless an equivalent tax is applied globally.

In September 2011, UK Chancellor George Osborne warned that the FTT could drive investment out of Europe, would threaten the interests of the City of London and could only work if a global deal were struck to ensure a level playing field. In December 2011, he warned that any revenues for the UK Government from the FTT would be offset by losses in other taxes.

In January 2012, at the World Economic Forum in Davos, UK Prime Minister David Cameron famously described the FTT initiative as “quite simply madness“, referring to the European Commission’s analysis that the FTT could reduce the GDP of the EU by some EUR200 billion, cost nearly 500,000 jobs and force as much as 90% of some markets away from the EU. Cameron told the French President François Hollande, before a G8 meeting in Washington in May 2012, that he would exercise the UK’s right to veto the FTT.

Once the proposal moved from an EU-wide tax to a tax charged only by participating Member States, the UK’s attitude has moved from antipathy to resigned acceptance. In October 2012, Osborne made it clear that “the UK would not be joining”, but added that “we would not seek to stand in the way of enhanced cooperation: however this must be done in the context of a clear proposal and in line with the treaty.” When the European Council formally approved the proposal, the UK abstained. Whilst not actively supporting the FTT, the UK did not attempt to block it.

However, the FTT is still on the UK Government’s radar, principally in terms of legality (will the requirements of the enhanced cooperation procedure be complied with and will the EU fundamental freedoms be respected?), the risk of relocation of financial transactions out of the City of London (will there be any consequential advantage in writing business in, say, New York or Singapore over London?) and double taxation (how can Member States avoid the same transaction being subject to national taxes, such as UK SDRT and the FTT?).
Clearly the FTT will impose a significant burden on the City of London as the largest financial centre in Europe, as the home to large branches of banks headquartered in participating Member States and as the centre of European OTC derivatives trading. Criticism has come from some quarters that by opting-out, London will still pay a large share of the FTT but will have no say in its design. This may be a worry in itself, but the risk of relocation of business to financial centres in the US or Asia (considered to be the key risk by many) has seemingly been mitigated, and indeed seem business may come to the UK from Europe. The UK Government will, however, remain alive to the issue.

**WHILE WAITING FOR A POTENTIAL IMPLEMENTATION OF THE PROPOSED FTT DIRECTIVE, HAS THE UK INTRODUCED, OR IS IT PLANNING TO INTRODUCE, A DOMESTIC FINANCIAL TRANSACTION TAX (OR A SIMILAR TAX, STAMP DUTY ETC)? IF YES, WHAT ARE THE MAIN FEATURES OF SUCH TAX AND HOW DO THEY COMPARE WITH THE PROPOSED FTT DIRECTIVE? ALSO, WOULD ANY SUCH DOMESTIC LEGISLATION BE ELIMINATED AS SOON AS THE PROPOSED FTT DIRECTIVE HAS ENTERED INTO FORCE?**

Notwithstanding the UK’s attitude to the FTT, taxes have been charged on transfers of financial instruments of one form or another in the UK since the nineteenth century by way of stamp duty and, since 1986, SDRT.

SDRT is charged on physical documents, and is therefore generally only relevant to transactions effected “off-exchange”, when a document is required. Most commonly, the duty is paid on private sales of shares in UK companies at 0.5% of the price. It is rarely paid on other types of financial transactions. We shall say no more about SDRT here, save that the potential for the charge is wide, and so must be borne in mind when dealing with “off-exchange” or other documented financial transactions.

SDRT was introduced as a response to the growing use of paperless electronic exchanges (which do not involve documents to which stamp duty can attach).

SDRT is charged on agreements to transfer securities, including shares, interests in funds and debt securities, although most debt securities benefit from one exemption or another. In practice, SDRT is a tax on transfers of shares in UK incorporated companies via the CREST settlement system (in which case the tax is collected from Euroclear UK and Ireland), and on transfers and redemptions of interests in UK equity funds (the tax is generally collected from the fund itself). SDRT is charged at 0.5% of the price paid for or the value of the security. The tax had also been imposed on issuances of securities into clearing or depositary schemes, but this is no longer collected as it was held to be incompatible with EU law.

There are some important exemptions for stock loans and repos over listed securities which are either effected on-exchange, or otherwise where either party is a regulated entity. Similar exemptions are available for transfers of listed securities to approved
intermediaries, such as brokers, dealers and market makers.

There are many differences between SDRT and the FTT: SDRT does not have the same potential for the “cascade effect” (due to the wide reliefs for intermediaries), its territorial reach is limited to the issuance principle (so that a sale of UK shares by a German resident to a French resident would be taxed, but a sale of German shares between UK residents would not) and, save in the case of a limited class of physically settled instruments, it is not charged on derivatives.

We doubt there is any practical likelihood of SDRT being abolished as a response to the introduction of the FTT. However, the potential for double taxation exists and is a concern for the UK Government: for example, the purchase of UK shares by a UK fund from a French resident could subject the fund to both SDRT and the FTT. The UK Government raises in the region of GBP4 billion each year from SDRT, and has stated that it intends to enter into discussions over double tax relief with participating Member States. It will be interesting to see whether either side will be willing to forgo revenue to achieve this.

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