Prepared by AmCham member

Deloitte.

Financial transaction tax: not just for banks

On February 14, 2013, the European Commission adopted a proposal for a Council Directive implementing enhanced cooperation in the area of Financial Transaction Tax (FTT). This proposal reflects the objectives of the original FTT proposal of September 2011, which previously failed to reach unanimous agreement by all 27 Member States. Nonetheless, eleven Member States (Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia) – the FTT zone – expressed a strong willingness to implement the FTT, and as of January 1, 2014, will have a green light.

Scope and Objectives

The objectives of the FTT remain basically unchanged. Due to the fact that the financial sector was found to be a major culprit of the crisis, which according to the Commission, was under-taxed and simultaneously received substantial government support, a mechanism had to be made to address the imbalance. Thus the FTT should be a tool that returns finances back to the system, and makes a proper distinction between those financial transactions that do and those that do not contribute to the real economy.

The reach of the FTT will be wider than non-participating Member States would desire. Specifically, the FTT shall be levied when at least one party to a financial transaction is established in the FTT zone and at least one party is a financial institution.

In addition to this already wide scope, the FTT shall also be levied for a party acting as a principal or agent in relation to a transaction that involves a financial instrument issued in the FTT zone. Therefore, the FTT is not only sensitive to the location of the parties to the transaction, but also to the location of the financial instruments themselves. This combination of both the residency and issuance principle extends the FTT outside the FTT zone.

Not Just for Banks

It goes without saying that banks fall under the definition of a financial institution; however, this definition is broad enough to cover insurance companies, pension funds, alternative investment funds and any other businesses for which financial transactions constitute more than 50% of turnover.

As the FTT would have to be paid by each financial institution involved, many transactions will be taxed twice (around 85% of the transactions have financial institutions on both ends). Nonetheless, to avoid the potential cascade effect of the FTT, when a financial institution acts in the name of, or on the account of another, only the second financial institution pays the FTT.

Since the FTT should not affect the real economy, the day-to-day financial activities of individuals and businesses such as deposits, insurance contracts, mortgage and business lending, credit card transactions, payment services, and spot currency transactions will be excluded from the FTT. In addition to the aforementioned transactions, neither primary issuance of shares nor bonds will not be taxed.

Rates and Taxable Amount

Shares and bonds, units of collective investment funds, money market instruments, repurchase agreements and securities lending agreements shall be taxed by 0.1%. Derivative products will be taxed at 0.01%. Participating Member States can apply higher rates if they so wish.

For financial instruments other than derivatives, the taxable amount of the FTT shall be a price or any other form of consideration. For derivative contracts, the taxable amount shall be the notional amount referred to in the derivative contract.

Payment and Reporting

For transactions carried out by electronic means, the FTT will be due immediately. In other cases, the FTT will be due within three days.

To secure the payment of the FTT, other parties to a financial transaction, including persons other than financial institutions, shall be jointly and severally liable for payment of the FTT if not paid by the deadline.

Anti-avoidance Measures

The expected contribution of financial institutions is €30-35 billion a year, which is substantial. Logically, financial institutions may seek relocation outside the FTT zone.

The European Commission addressed this potential leak by implementing the aforementioned issuance principle. Therefore, financial institutions would only be able to avoid the FTT if they relocate and, at the same time, leave all their clients and business partners in the FTT zone.

Impact and Timing

In terms of timing, participating Member States are to publish and adopt the national FTT laws by September 30, 2013, at the latest.

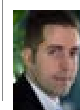
By all means, this is an aggressive and optimistic timetable, which, at the moment, seems difficult to meet in practice. However, the FTT will effectively work only if adopted by a large group of jurisdictions. Therefore, pressure on its timely implementation throughout the entire FTT zone can be expected and financial institutions should be well prepared.

Practical Examples

A Hong Kong bank writes an interest rate derivative with a German customer. As the counterparty to the Hong Kong bank is established in Germany, the bank is liable to pay a 0.01% of the notional value of the interest rate derivative.

A Swiss bank enters into a trade over Spanish government bonds with a Swiss customer. The Swiss bank is party to a financial transaction in a financial instrument issued in the FTT zone. The Swiss bank is liable to pay 0.1% Financial Transaction Tax (FTT) of the price paid for the bonds.

AA UK broker sells Dutch shares to a US pension fund. As there is no link to the FTT zone, no FTT applies.



Jan Skorka
Manager VAT, Deloitte