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DENTONS

EU divided over financial transaction tax

“All markets. All instruments. All actors.” is the motto of the Commission, or at least 11 EU Member States, in relation to the contemplated introduction of a financial transaction tax (FTT). The scope of the FTT should cover transactions on regulated markets as well as over-the-counter transactions, and should apply with respect to numerous types of transactions of financial institutions.

According to the Commission, the financial sector is currently ripe for additional taxation, and has played a major role in causing serious economic problems recently. The FTT should therefore ensure that the financial sector makes a fair contribution to public finances, and partly compensates the public costs of dealing with the recent economic crisis. Additionally, the application of the “too big to fail” policy by governments has resulted in the creation of incentives for transactions that do not enhance efficiency, thus making the financial market more aggressive than is natural and desirable.

The evolution of this project started in 2010, right after the end of the worst economic impact of the US financial crisis. In 2011, the Commission proposed to introduce the FTT throughout the EU. The proposal did not receive full support from the EU 27; neither was there a possibility for a unanimous agreement in the foreseeable future. For this reason, 11 EU Member States (FTT jurisdictions) decided to take action by requesting that the Commission (Council) authorize the introduction of the FTT among themselves via a form of enhanced cooperation under Article 329 of the Treaty of the Functioning of the European Union (TFEU). In the Council´s decision 2013/52/EU (Council Decision), the cooperation was blessed.

As you may have heard, the United Kingdom launched a legal claim against the FTT over one year ago. Since there is not any FTT EU Directive in place yet, the action was aimed at the Council Decision. The main plea concerned a claimed infringement of Article 327 of the TFEU, on the basis of which any enhanced cooperation shall respect the competencies of those Member States of the EU which are not part of such enhanced cooperation (i.e. the UK). The UK challenged the illegal extra-territorial taxation effects of the FTT on the basis of the “the counterparty principle” and “issuance principle”.

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The Court of Justice of the European Union swiftly dismissed the UK´s claim due to its prematureness, however it did not cast any doubt on the merits of the arguments used by the UK in the claim. Obviously, the UK must have known that legal action could be considered to be premature, since the action was aimed at the Council Decision, which does not deal with any constituent elements of the contemplated FTT. We can therefore assume that the UK might have brought this action as a precaution, in order to confirm that a subsequent legal challenge is possible. Had the UK not adopted such an approach, it could have been prohibited to launch any claim once a FTT EU Directive will be established.

The latest version of the FTT EU Directive proposal from 2013 suggests taxing securities trading by 0.1% of the market price and derivatives agreements, and “financial-market best” by 0.01% of the underlying nominal or face amount, which is used to calculate payments made on a given derivative contract. These are the lowest possible rates that can be fixed upwards by each FTT jurisdiction individually. In both cases, the FTT should be paid by the financial institutions involved. As a general rule, if at least one party to the financial transaction is established in the territory of any FTT jurisdiction and that a financial institution established in the territory of any FTT jurisdiction is party to the transaction (acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction), such a transaction is subject to the FTT.

The so-called “counter-party principle” applies, which means that a financial institution from a non-FTT jurisdiction is deemed to be established in a FTT jurisdiction provided that it is party to a transaction with a party or another financial institution established in a FTT jurisdiction. Additionally, if none of the parties/financial institutions to the transaction are established in a FTT jurisdiction, but the product or one of the financial instruments has been issued in the FTT jurisdiction (“issuance principle”), FTT takes place. On this note, please find below some examples.

1. A Slovak insurance company purchases shares from a Czech bank. FTT is due in Slovakia and the Czech Republic at national rates.
2. A US fund sells Slovak bonds to a Chinese bank. FTT is due in Slovakia as both financial institutions are regarded as being established in Slovakia for FTT purposes.
3. An Austrian fund manager manages a portfolio of securities for a Slovak client and purchases UCITS established in France. FTT is due both in Austria and in France.

In closing, let me just share with you some other Commission´s mottos about the FTT: “Those who want to serve the EU 11 market will have to pay the FTT!” or “EU 11 is *too big* a market for not being served by financial institutions.”

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