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A legal update from Dechert's International and Domestic Tax Group

European Commission Proposes Financial Transactions Tax

The European Commission have just released details of their proposal to introduce a Financial Transactions Tax ("FTT"). This follows on from high profile statements of support for the introduction of an EU FTT from the French and German governments. The EU's proposal envisages that the tax would come into effect from 1 January 2014 and it is the EU's hope that it would also serve as a platform for the introduction of a global FTT.

Rationale for FTT

The Commission believes that the introduction of FTT would be an appropriate way to ensure that the financial sector (which it currently believes is under-taxed) makes a fair contribution to the cost of the financial crisis having benefited from significant financial support from governments since it began. In addition, the Commission is of the view that an EU level of FTT would help avoid competitive distortions and discourage risky trading strategies.

The Commission also recommends that part of the revenues raised by FTT should be paid directly to the EU rather than all to the governments within whose territories the tax has been collected. The FTT is a major element of the Commission's proposals to reduce its reliance on national contributions with its own resources.

Key Features of FTT

FTT would apply to financial transactions carried out by financial institutions. Financial transactions would include the purchase and sale of shares, bonds, derivatives and structured financial products. However, it excludes residential mortgages, bank loans, insurance contracts and "day to day" financial activities. The Commission has proposed a minimum tax rate for the trading of bonds and shares of 0.1% and 0.01% for derivative products. This would be calculated by reference to the actual consideration paid (or market value where higher) or the "notional amount" in the case of a derivative contract. The tax would be paid by each EU-based financial institution which is a party to the transaction (and where there is more than one such financial institution the tax would be shared between them).

Financial institutions within the scope of FTT would include investment firms, organised markets, banks, insurance companies, pension funds, collective investment schemes, leasing companies and special purpose vehicles (such as securitisation SPVs). It is also important to appreciate that as well as covering financial institutions incorporated in the EU or operating a branch operation in the EU, it would also include such entities authorised in an EU member state, and non-EU entities which are a party (whether as principal or agent) to a financial transaction with an EU based financial institution, e.g., a US fund entering into a derivative with a German company.

The tax would be collected by banks, brokers or dealers or alternatively exchanges, central counterparties or central depositories could be given the role. Every person liable for FTT would be required to submit monthly tax returns to its EU member state.

Dechert Comment

Although liability for the tax would be that of the relevant financial institutions which are a party to the transaction, according to the IMF, most of the burden of FTT may well fall on consumers.

The Commission estimates that depending upon market reactions the revenues of an EU FTT could be €57 billion per annum throughout the EU. However, if FTT is only introduced on an EU-wide basis, there would inevitably be scope for securities and derivative trading to move outside the EU due to the highly competitive and mobile nature of the markets. There may also be opportunities for avoiding FTT by undertaking transactions which are economically equivalent to transactions which would otherwise be subject to FTT or a higher amount of FTT but which themselves are not within the scope of FTT.

Although the proposal is for an EU FTT it would also have a potential impact on non-EU financial institutions which are caught by the tax if a party to certain transactions. It would also catch dealings in non-EU shares, bonds etc if one of the parties to the transaction is EU-based. Further non-financial institutions which are a party to the tax are also jointly and severally liable for it along with the relevant EU financial institutions.

Most EU member states have stated that they are in favour of introducing FTT but the UK, while not opposed to the introduction of a global FTT, is opposed to an EU FTT (the introduction of which would likely require the abolition of UK stamp duty). Since the proposal requires unanimous approval of all EU member states, the UK would be in a position to block the introduction of an EU-based FTT. However, there is an "enhanced co-operation procedure" under which a number of member states can be authorised to exercise EU non-exclusive competencies through the EU institutions, with the purpose of protecting the EU's interests and reinforcing its integration process. One potential risk here for the UK government is that if FTT was introduced in this manner without the UK participating it would still impact on UK financial institutions through trades with counterparties within the scope of FTT but the UK would not share in any of the revenue generated.

Although the introduction of an EU FTT still appears to be unlikely, nevertheless it is clear that the case for its introduction has gathered significant momentum recently and is also thought to be supported by most EU member states. The European Commission, in particular, seems extremely keen to implement an FTT on one basis or another despite the potential negative impact on GDP. Furthermore, European policymakers are keen to put this issue firmly on the political agenda before the next meeting of the G20, scheduled for early November. Accordingly, the debate is one to be taken seriously and those who are potentially adversely affected by the introduction of such a measure and relevant industry bodies should consider lobbying against its introduction on a national and/or EU-wide basis at the earliest opportunity.

Practice group contacts

For more information, please contact one of the lawyers listed below or the Dechert lawyers with whom you regularly work. Visit us at www.dechert.com/tax.

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Adrienne M. Baker
Boston
+1 617 728 7151
adrienne.baker@dechert.com

Frederick J. Gerhart
Philadelphia
+1 215 994 2838
frederick.gerhart@dechert.com

Daniel Hawthorne
London
+44 20 7184 7327
daniel.hawthorne@dechert.com

Daniel M. Dunn
New York
+1 212 698 3857
daniel.dunn@dechert.com

David Gubbay
London
+44 20 7184 7420
david.gubbay@dechert.com

Richard M. Hervey
New York
+1 212 698 3568
richard.hervey@dechert.com

Michael Hirschfeld
New York
+1 212 698 3635
michael.hirschfeld@dechert.com

Michael J. Rufkahr
Washington
+1 202 261 3437
michael.rufkahr@dechert.com

Mark Stapleton
London
+44 20 7184 7591
mark.stapleton@dechert.com

Edward P. Lemanowicz
Philadelphia
+1 215 994 2492
edward.lemanowicz@dechert.com

David G. Shapiro
Philadelphia
+1 215 994 2456
david.shapiro@dechert.com

Richard P. Wild
Philadelphia
+1 215 994 2670
richard.wild@dechert.com

James H. Nix
New York
+1 212 698 3595
james.nix@dechert.com