EU Commission adopts its new proposal for an EU Financial Transaction Tax

Global FS Tax Newsflash

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As expected, the European Commission today presented its "new" draft proposal for a Council Directive implementing a financial transaction tax (FTT) in 11 countries. The draft is largely the same as the original proposal released in September 2011 but contains some important changes. The draft Directive continues to have a very broad scope and will impact both EU and non-EU financial institutions. The cost of the tax, coupled with the major operational changes that will be required to comply with the regime, mean that the EU FTT will result in significant cost for financial institutions and their clients. Outside of the 11 countries who have formally joined the Enhanced Cooperation on FTT, we believe that 7 other countries already operate some form of FTT. We believe that FTT, including eventually the 11 states, will be a part of the fiscal landscape in the future. Given this, and the challenges of making the operational changes to comply with a new EU FTT, financial institutions need to be working on a strategy and implementation plan as soon as possible. Financial Services institutions outside of the EU will be liable to pay the FTT in relation to certain transactions.

Changes to previous draft

The new proposal is largely based on the Commission's September 2011 proposal. It is similarly very wide in scope, both in terms of the types of transactions in scope and the financial instruments in scope. The proposal retains the approach of applying the tax to transactions involving a financial institution and placing the liability for the tax on all financial institutions involved in a transaction.

However, as expected, some changes were made to the September 2011 draft. The principal changes are as follows:

1. The 'FTT zone' is now limited to the participating Member States (currently Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain).

2. For the purposes of determining where an entity is 'established' under the regime, the new Directive adds the "issuance principle" to the definition of establishment.

   This means that a financial institution with no nexus with the FTT zone can now be liable to the tax when it is involved in a transaction over instruments issued by a company in the FTT zone.

   As with the prior draft, trading with a counterparty in the FTT zone is also sufficient to bring a financial institution within the scope of the tax. The scope for a non-FTT zone financial institution to be taxed is therefore even wider under the new draft.

3. The new draft confirms that depositary receipts issued outside of the FTT zone, but with FTT zone securities underlying, are within scope.

4. New exemptions are included for the issuance of shares and units in UCITS funds and the exchanges of stock in mergers.

Scope of transactions covered

The scope of transactions covered by the FTT in the new proposal continues to be very wide and includes most transactions in financial instruments, which are defined to include equities, bonds, foreign currency (excluding spot contracts) and derivatives, whether conducted on a regulated market or on an OTC basis.

The new draft clarifies that exchanges of financial instruments should be treated as two taxable transactions. However, repo and reverse repo transactions, and securities lending and borrowing agreements, are to be treated as giving rise to one transaction only.

Taxable amount and rate

The tax base and rates of tax are unchanged from the previous draft. For financial transactions other than derivatives, the taxable amount is the consideration paid (or market value, if higher). The taxable amount in relation to derivative transactions is the notional amount specified in the contract at the time the derivative is entered into. The draft Directive provides that the rate of FTT will be set by each Member State, subject to a minimum rate of 0.1% for financial transactions other than derivatives and 0.01% for derivatives.

Parties within the charge to FTT

The scope of the tax continues to be focused on financial institutions acting as party to a financial transaction, either for their own account or for the account of other persons, or acting in the name of a party to the transaction.

The definition of financial institutions is broad and includes investment firms, organised markets, credit institutions, insurance and reinsurance undertakings, collective investment undertakings and their managers, pension funds and their managers, holding companies, financial leasing companies and special purpose entities. Where possible these are defined by reference to EU regulatory legislation.

Other entities can also qualify as financial institutions if they carry out certain financial activities. The new draft introduces a revenue-based test for determining whether such entities fall within the regime (entities carrying out the prescribed activities will qualify as financial institutions if they derive more than 50% of their overall average net annual turnover from financial transactions).

Exemptions

As with the previous draft, the new draft Directive contains very few exemptions. In particular, the draft contains no market maker exemption. Coupled with the incidence of an FTT charge on each financial institution involved in a transaction, this means that multiple charges will often arise under a single transaction.

Certain institutions and bodies continue to be exempt from the tax, including central counterparties, central securities depositories (however, it is possible that these institutions will be involved to some degree in the collection and administration of the tax for certain financial instruments and transactions), Member States and public bodies thereof. Transactions with the European Central Bank and national central banks will also be excluded from the scope of the FTT.

Compliance with FTT

The FTT will be payable to the tax authorities of the Member State in which the financial institution is deemed to be established. Each liable financial institution is required to report its tax liability to the relevant jurisdiction. Each party to a transaction, including persons other than financial institutions become jointly and severally liable for the payment of the tax due where tax due has not been paid within the time limit set in the draft Directive.

The new draft makes reference to the development of “uniform collection methods” and establishing ways of “ensuring proper payment of tax”, but includes little detail on the practicalities of paying tax under the regime.

Impact assessment

The Commission decided that a new impact assessment would not be appropriate (notwithstanding the increased scope arising from introducing the issuance principle). The Commission anticipates annual revenues of 34 billion Euro from the regime.

Timing

The draft Directive still proposes a start date for the FTT regime of 1 January 2014. However, we consider this timeframe to be very ambitious given the issues that need to be agreed upon before the regime can come into force (including the final form of the EU FTT and who will receive FTT revenues).

Impact on local FTTs

The participating Member States cannot maintain or introduce taxes on financial transactions other than the EU FTT. In particular, this means that the French and Italian FTTs would need to be repealed.

Existing national FTTs in Europe outside the FTT zone (such as UK SDRT) will continue to exist. This may lead to double taxation under the Commission's proposal.

There are indications that countries which were considering implementing their own domestic FTT (e.g. Portugal and Spain) appear to be pulling back from this in anticipation of discussions on EU FTT now moving ahead within a relatively short timeframe.

Next steps

Firstly, the technical aspects of the new EU FTT proposal will be discussed in the normal Council Working Party on Taxation Issues Subgroup on Indirect Taxation. The first technical Council working group meeting on FTT will be held on 21 February 2013.

These technical meetings are chaired by the EU Presidency, with all 27 EU Member States present, with the non-participating Member States having to "act in good faith". These discussions will therefore be an open and transparent process.

Member States can join the core group of 11 Member States at any time throughout the Enhanced Cooperation Process under the principle: "once you're in, you stay in".

After the technical work is completed, the proposal will move up within the Council to the political level for a vote. The timing of this next stage will depend on the EU Presidency and, likely, Germany and France.

In order to be implemented, the draft Directive needs to be discussed by the 27 EU Member States at the EU Council of Ministers, put to the European Parliament for a non-binding Opinion, and then agreed unanimously by the participating Member States.

Only the EU-11 which have formally joined the Enhanced Cooperation on FTT have the right to participate in the final vote in an ECOFIN meeting on the final shape of the harmonised FTT.

Implications

In our view, the key implications arising from the latest draft are as follows:

- In its current form, the EU FTT regime will result in a significant operational burden for financial institutions. The cost of implementing systems and processes to deal with the regime, together with the very high revenue estimates proposed by the Commission, mean that the cost for financial institutions and their clients will be significant.
- Given that the proposed start date of 1 January 2014 seems very challenging to meet, there is a risk that more countries will introduce domestic FTTs if the start date is pushed back.
- Now that we have a draft Directive and the 11 countries have approval to introduce an EU FTT, financial institutions should be evaluating the impact of the regime on their businesses. This will allow institutions to identify their key areas of concern and develop a lobbying strategy. With

negotiations on the new draft Directive set to start imminently, now is the time to start lobbying efforts.

- The fact that the EU FTT proposal has got to this stage – a draft Directive that 11 countries have been authorised to negotiate and introduce into law – shows the strength of political will behind FTT regimes. Wherever the EU FTT proposals end up, it is clear that FTTs will be a feature of the tax landscape for years to come.

PwC contacts

If you would like further advice or information in relation to the issues outlined above, please call your local PwC contact or any of the individuals listed below:

David Newton
Global FS Tax Leader
T: +44 (0)207 804 2039
david.newton@uk.pwc.com

Hans-Ulrich Lauermann
Global Banking and Capital Markets Tax Leader
T: +49 69 9585 6174
hansulrich.lauermann@de.pwc.com

Bob van der Made
EU Public Affairs Brussels
PwC Netherlands
T: +31 (0) 88 792 3696
bob.van.der.made@nl.pwc.com

Peter Barrow
Global Insurance Tax Leader
T: +44 (0) 207 904 2062
peter.barrow@uk.pwc.com

William Taggart
Global Asset Management Tax Leader
T: +1 646 471 2780
william.taggart@us.pwc.com

Frans Oomen
PwC Netherlands
T: +31 (0) 88 792 5156
frans.oomen@nl.pwc.com

Matthew Barling
PwC UK
T: +44 (0) 207 212 5544
matthew.barling@uk.pwc.com

Joseph Foy
PwC US
T: +1 (646) 471 8628
joseph.foy@us.pwc.com

Peter Yu
PwC China/HK
T: +852 2289 3122
peter.sh.yu@hk.pwc.com

Simon Leach
PwC UK
T: +44 (0)20 7213 4381
simon.j.leach@uk.pwc.com

Peter Churchill
PwC UK
T: +44 (0)20 7804 0865
peter.j.churchill@uk.pwc.com

Maud Poncelet
PwC France
T: +33 (1) 56 58 18 35
maud.poncelet@fr.landwellglobal.com

PwC Singapore

Paul Lau
T: +65 6236 3733
paul.st.lau@sg.pwc.com

David Sandison
T: +65 6236 3675
david.sandison@sg.pwc.com

Gavin Helmer
T: +65 6236 7208
gavin.rh.helmer@sg.pwc.com

Tan Hui Cheng
T: +65 6236 7557
hui.cheng.tan@sg.pwc.com

Anuj Kagalwala
T: +65 6236 3822
anuj.kagalwala@sg.pwc.com

Tan Tay Lek
T: +65 6236 3768
tay.lek.tan@sg.pwc.com

Carrie Lim
T: +65 6236 3650
carrie.cl.lim@sg.pwc.com

Yip Yoke Har
T: +65 6236 3938
yoke.har.yip@sg.pwc.com

Lim Maan Huey
T: +65 6236 3702
maan.huey.lim@sg.pwc.com

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