Financial Transaction Taxes:
Developing a strategic response
Point of view
“FTTs will fundamentally change the tax landscape for financial institutions...The EU Commission has estimated that the EU FTT will raise €31 billion”

Financial Transaction Taxes (“FTTs”) will fundamentally change the tax landscape for financial institutions. These taxes will have wide-reaching implications for the business models of all financial institutions, regardless of where institutions are located and where they transact.

In the past 18 months a number of countries have either introduced or announced an intention to introduce domestic FTTs at a local country level. In addition, a proposal to introduce a FTT in a subset of the European Union (“EU”) has been approved.

So, what are FTTs and where did they come from?

What are Financial Transaction Taxes?
FTTs are a form of indirect tax levied on specific financial transactions, such as purchases of equity securities.

A number of countries have long had domestic FTTs, including the UK, Hong Kong and Switzerland.

Why are new FTTs being introduced?
The development of FTTs in recent years has its roots in a request by the G20 to the IMF to find ways of ensuring the financial services sector makes a ‘fair and substantial contribution’ towards the costs of the financial crisis.

Although the IMF report1 ultimately concluded that a FTT was not its favoured option, the EU continued to consider the introduction of an EU wide FTT.

In September 2011, the EU released a draft Directive for an EU FTT, with a planned start date of 1 January 2014. This represented the first attempt to introduce a common FTT regime across all EU countries.

Since then, various countries have sought to ‘front run’ the EU FTT developments by introducing their own, domestic FTTs.

Why have FTTs come to favour?
At a time of high fiscal deficits in most western countries (see figure 1), FTTs are highly attractive politically as a revenue raising tool. Indeed, the EU Commission has estimated that the EU FTT will raise €31 billion, which would be a considerable cost to financial services institutions and their clients.

Moreover, the support for FTTs is representative of a number of trends in taxation, including:

• the use of taxes to change the behaviour of financial institutions
• increased use of indirect taxes rather than direct taxes
• increased taxes levied on the financial sector

For all of these reasons, in our view, financial transactions taxes will be a feature of the tax landscape for many years to come.

Who is impacted by FTTs?
In summary, any financial institutions involved in securities business are likely to be directly impacted by new FTT regimes. In particular, banks, brokers, asset managers, insurers, and custodians all need to be developing a response to these developments. For these reasons, FTTs have significantly changed the tax landscape for financial institutions.

Is this an issue for non-EU institutions?
In short, the answer is yes. FTTs may be charged by reference to the location of the issuer of taxable securities, regardless of where the parties to the transaction are located (this is the model for the French FTT, for example).

An alternative model (which was incorporated in the September 2011 draft EU Directive) taxes a financial institution based on where it, or the counterparty to the transaction, is located. Under this model, an institution outside of the FTT jurisdiction can be subject to the tax by trading with a counterparty resident in the FTT jurisdiction.

Figure 1: individual country deficits, as published on 9 February 2013

<table>
<thead>
<tr>
<th>Country</th>
<th>Budget balance as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>-7.0</td>
</tr>
<tr>
<td>Japan</td>
<td>-0.8</td>
</tr>
<tr>
<td>Britain</td>
<td>-7.9</td>
</tr>
<tr>
<td>France</td>
<td>-4.5</td>
</tr>
<tr>
<td>Germany</td>
<td>+0.1</td>
</tr>
<tr>
<td>Greece</td>
<td>-7.0</td>
</tr>
<tr>
<td>Italy</td>
<td>-3.0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>-4.1</td>
</tr>
<tr>
<td>Spain</td>
<td>-7.4</td>
</tr>
</tbody>
</table>

Source: The Economist, February 9th 2013

“FTTs have a significant adverse impact at an economic level. FTTs can result in increased costs to companies issuing securities...and present a risk of relocation of activities.

For a very broad-based EU FTT...implementation costs of $15 – 20 million would seem likely for large financial services organisations with a European footprint”

Notwithstanding the attractiveness of FTTs to governments, research and experience from the introduction of FTTs has suggested that FTTs have a significant impact at an economic level.

There have been a number of studies into the economic impact of introducing FTTs.

In the context of the UK’s stamp tax regime, research has suggested this has had a number of economic effects on the UK economy as well as UK companies (see Figure 2).

When a financial transaction tax was introduced in Sweden in the 1980s on the purchase and sale of domestic equities and stock options, this had a significant effect on the Swedish markets (including the migration of an estimated 50% of trading activity from Sweden to the UK).

The economic impact of any new FTT will depend on the precise nature of the regime. One key aspect is whether tax is levied by reference to the location of the issuer of the securities (as with UK Stamp Duty Reserve Tax (“SDRT”) which broadly applies to transfers of equities issued by UK companies) or by reference to the location of the parties to the transaction.

The first model could be expected to result in increased costs to companies issuing securities, and add cost to parties trading those instruments.

The second model provides a greater risk of relocation of activities as institutions which are located outside of the FTT zone and who do not trade with counterparties inside the zone will not be subject to the tax.

These points are not simply of academic interest. They can be used to inform institutions' engagement with governments, specifically around the practical issues and the shape any proposed regime should take. They will also be highly relevant to assessing the impact of a new regime at an institutional level. These points are discussed in further detail later in this document.

<table>
<thead>
<tr>
<th>Figure 2: Impacts of UK stamp tax¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Reduction in the share prices of UK companies</td>
</tr>
<tr>
<td>• Increased cost of equity for UK companies</td>
</tr>
<tr>
<td>• Reduced liquidity in UK shares in the secondary markets</td>
</tr>
<tr>
<td>• Reduced UK GDP and tax receipts</td>
</tr>
</tbody>
</table>


Compliance and implementation costs

Our experience with the French FTT, and to some extent the Italian FTT, gives us an indication of what the implementation costs are likely to be for financial institutions.

For the individual country FTTs, the implementation costs for financial institutions were estimated to be $2-3 million per country. The implementation costs of an EU wide FTT are therefore likely to be significant.

Although it would be hoped that some economies of scale could be achieved, for a very broad-based EU FTT (along the lines of the current EU Commission proposal) and based on recent experience of individual country FTT implementation, total implementation costs of $15 – 20 million would seem likely for large financial services organisations with a European footprint.
The EU FTT is now coming into force across a subset of EU countries. So, how did this come about, what happened to the planned EU wide FTT, and where does this regime stand?

From the outset, this topic has been highly political with a range of views expressed by different governments. France and Germany in particular have been very strongly in support of the proposal, whilst the UK and certain other countries have been strongly against it.

The original intention was for the FTT to apply to all EU Member States. Once it became clear that this could not be achieved given the opposition of certain countries, a number of countries moved for the introduction of an EU FTT in those countries only through a process known as the Enhanced Cooperation Procedure (“ECP”). This procedure allows a subset of at least 9 Member States to proceed with introducing progressive EU law within those supporting States only.

On 22 January 2013, a vote was passed (with four countries abstaining) to allow the 11 countries in favour of the EU FTT to proceed with the introduction of the tax. The Netherlands may join the ECP, but this is subject to certain conditions on the nature of the final regime (see Figure 3).

The EU Commission released a new draft of the Directive on 14 February 2013. The details of the revised proposal are set out in the Appendix.

The next steps in the process are as follows:
- The precise provisions of the Directive will be debated. All EU Member States will be present at these debates.
- Once the technical debate has concluded, the process will move to the political level.

Only the (currently 11) Member States, which have formally requested to the Commission to join the Enhanced Cooperation on FTT, have the right to participate in the final vote on the FTT regime at the Council political level. The vote requires unanimity to pass.

Throughout the ECP process, Member States can send a formal request to the Commission to join the core group of 11 Member States in favour of the EU FTT. Based on the current draft Directive, once an EU FTT is enacted those countries signed up to the FTT will not be able to retain existing, domestic FTTs.

In summary, in what continues to be a process of close consultation with governments, the EU FTT is likely to become a reality. Although the Commission’s proposal forms a formal basis for what are complex talks between Member States, the current proposal may still be considerably diluted. The key issues to be determined in the coming months are the precise shape of the EU FTT and when it will come into force. We understand however that it is increasingly uncertain whether a compromise can be reached before the German elections in September 2013. This means that the proposed timeline may shift.
Over the coming months, there are a number of key events both with respect to the EU FTT and domestic FTTs.

For the EU FTT, we will now see the start of negotiations on the precise form of the EU FTT following the release of the revised Commission proposal on 14 February 2013. In parallel, domestic FTTs will be coming into force (and it remains possible that more countries will seek to introduce FTTs locally, especially if the EU timetable were to be extended).

The events of the next 12-18 months will therefore be key in shaping the FTT landscape. For this reason, institutions need to start planning for these events now. The timeline below sets out the key events on the EU FTT and domestic FTTs as the position currently stands, together with some key developments from recent months.
Financial institutions will need to prepare, develop strategies for and deal with multiple FTTs implemented by local countries in the short to medium term.

As the negotiation and debate around the EU FTT has continued, a number of countries have either introduced, or announced an intention to introduce, their own FTTs. The current status of the major countries with an FTT-style tax is set out below. Each of these domestic FTTs has different scopes, rates, and exemptions, etc.

Accordingly, until the introduction of the EU FTT financial institutions will be faced with a patchwork of local country FTTs, all with different features – a very difficult situation to manage.

As mentioned before, under the terms of the current draft EU FTT Directive those countries signing up to the Directive cannot retain their domestic FTTs. That said, even once the EU FTT is introduced local implementation may still differ. For example, the Directive will only specify minimum rates of tax – these could therefore differ at a local country level.

<table>
<thead>
<tr>
<th>Country</th>
<th>Italy</th>
<th>France</th>
<th>Portugal</th>
<th>Spain</th>
<th>Hungary</th>
<th>Ukraine</th>
<th>EU</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope of tax</strong></td>
<td>Charged on the sale of Italian equities and ADRs, transactions in Italian equity derivatives and high frequency trading of taxable instruments</td>
<td>Acquisition of equity and similar securities issued by a French listed company having a market cap in excess of €1bn (and ADRs over such). Tax on high frequency trading and certain CDS by Spanish entities</td>
<td>Secondary market transactions over financial instruments, including equities, bonds and fund units, derivative transactions</td>
<td>Acquisition of equity and similar securities issued by large Spanish companies. Tax on high frequency trading and certain CDS by Spanish entities</td>
<td>Money transfers, collections, payments, cash disbursements, cash transfers, redemptions of letters of credit and cheques, and certain central bank deposits</td>
<td>OTC transfers of Ukrainian securities and OTC transactions over Ukrainian derivatives</td>
<td>Transactions involving a financial institution, with a party established in an ECP country, over equities, bonds, money market instruments, derivatives and UCITS units</td>
</tr>
<tr>
<td><strong>Rate of tax</strong></td>
<td>0.1% for equities traded on regulated securities exchanges, 0.2% otherwise (0.12%/0.22% for 2013). Nominal rates applied to derivatives</td>
<td>0.2% shares, 0.01% for high frequency trading and CDS</td>
<td>Up to 0.3%</td>
<td>To be confirmed</td>
<td>In most cases 0.01%, but in some cases up to 0.3% depending on the transaction</td>
<td>0.1% for listed securities, 1.5% for unleaded securities</td>
<td>0.1% for non derivatives, 0.01% for derivatives</td>
</tr>
<tr>
<td><strong>Key reliefs</strong></td>
<td>Primary market transactions, market maker transactions</td>
<td>Primary market transactions, market maker transactions, stock loans, repos, infra-group transactions</td>
<td>Issuance of securities, potentially market makers (to be determined)</td>
<td>Primary market transactions, market maker transactions</td>
<td>Various, including accounts held at the same bank by the same person, cash pooling and securities accounts</td>
<td>Primary market transactions, transactions over government securities</td>
<td>Primary market transactions; transactions with certain government bodies, certain group restructuring transactions</td>
</tr>
<tr>
<td><strong>Expected Start date</strong></td>
<td>Equities tax from 1 March 2013, derivatives tax from 1 July 2013</td>
<td>Effective from 1 August 2012</td>
<td>2013/2014</td>
<td>Potentially first half of 2013</td>
<td>1 January 2013</td>
<td>1 January 2013</td>
<td>1 January 2014</td>
</tr>
</tbody>
</table>
For some time financial institutions have had to deal with domestic FTTs. Accordingly, the introduction of more FTTs that need to be managed means that financial institutions must prepare to deal with this dynamic landscape.

The table below sets out the features of some of the main existing FTT regimes. In developing a strategic response to the introduction of new FTTs, to the extent possible financial institutions should seek to leverage the experience and lessons learned from dealing with these existing FTTs (this theme of building from experience of existing regimes is discussed further later in this document). This is particularly true for FTT regimes that tax equity transactions, since this forms the basis for most FTT regimes already in existence.

<table>
<thead>
<tr>
<th>Country</th>
<th>Hong Kong</th>
<th>Ireland</th>
<th>South Africa</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope of tax</td>
<td>Charged on the transfer of stock which is registered in Hong Kong by way of sale and purchase</td>
<td>Charged on transfer of stock in Irish incorporated companies</td>
<td>Securities transfer tax applies on the transfer of South African securities or listed securities</td>
<td>Securities transfer tax applies to transfers of qualifying securities, wherever issued, involving Swiss parties</td>
<td>Agreements to the transfer of UK equities and certain UK securities with equity-like features</td>
</tr>
<tr>
<td>Rate of tax</td>
<td>0.20% shared between the buyer and seller of the chargeable security</td>
<td>1%</td>
<td>0.25%</td>
<td>0.15% for Swiss securities, 0.3% for non-Swiss securities</td>
<td>0.5%</td>
</tr>
<tr>
<td>Key reliefs</td>
<td>Exemption for transfer between associated companies (i.e. those with a 90% association)</td>
<td>Exemptions for intermediaries, transfers between companies within a group relief group, foreign transfers and stock borrowing</td>
<td>Exemptions for asset to share transactions and intra group transactions</td>
<td>Exemptions for certain capital markets transactions, including stock lending</td>
<td>Exemptions for intermediaries, certain capital markets transactions (including stock loans) and transfers within a group</td>
</tr>
</tbody>
</table>
The EU FTT will impact financial institutions globally and not just those based in the European countries.

This is for two key reasons:
1) under the current Commission proposals, a financial institution located outside of the ECP zone that is a party to an in-scope financial transaction with a counterparty established within the ECP zone is subject to the tax; and
2) it is likely that the majority of the economic cost of the FTT will be passed on to the end investor by the financial institution.

Even if the ECP countries choose to push ahead with an FTT which is closer to a more traditional stamp-style regime, any company or individual entering into a transaction over securities issued by companies located within the ECP zone will be subject to the FTT.

For example, see Figure 4 below. In Scenario (1), the Japanese bank is subject to the EU FTT as a result of transacting with a German counterparty despite having no physical presence within the ECP zone. This contrasts with the stamp model where the German Bank would normally be the accountable party.

Likewise under Scenario (2), the UK broker dealer in selling shares in a Swiss company would be brought within the scope of the EU FTT by virtue of transacting with a bank situated within the ECP zone.

In both scenarios, the US corporate is likely to bear the economic cost of the FTT indirectly through increased brokerage fees in the case of Scenario (1) or through the pricing of the CFD in the case of Scenario (2).

Figure 4: the global impact of an EU FTT

1. German bank acting for a US corporate customer buys French equities from Japanese Bank and sells to its customer

2. German bank writes CFD over Swiss equities with US corporate and hedges CFD by purchasing reference equities from UK Broker Dealer

Key
★ Charge under EU FTT
★ Charge under French FTT
At this stage, it is not clear what the final form of the EU FTT will be, nor is it clear when the EU FTT will ultimately take effect. However, in our view financial institutions need to develop a strategic response now.

Notwithstanding uncertainty on how EU and domestic FTT regimes will develop, in our view financial institutions cannot afford to ignore the FTT developments and wait for clarity. There are a number of reasons for this.

1. FTTs are not going away
As we have discussed earlier, FTTs are politically attractive and regarded as a valuable new source of revenue for governments. Given this trend, financial institutions need to be prepared to deal with FTTs over the foreseeable future.

2. FTTs can have a significant impact on financial institutions
In our experience, FTTs impact institutions in a very wide range of areas. FTTs can impact the viability of business lines, product pricing, operational and systems requirements, legal agreements with clients, and many other ways besides the direct impact of the FTT.

3. The final shape of many regimes is not yet decided
With the shape of certain FTT regimes (including, in particular, the proposed EU FTT) not yet finalised, there remains time for discussions with government and the EU to refine the precise form of these taxes. For example, banks and brokers would want to ensure that any new FTT has a broad based exemption for market makers (the current EU Directive contains no such exemption).

For asset managers, a key issue will be the scope of any charge on the issue and redemption of shares or fund units.

However, to make their voices heard now, financial institutions need to assess the impact of proposed regimes and engage governments in discussion.

4. FTTs can have a very short lead time
Recent experience from the French and Italian FTTs has shown that FTTs can be introduced with very little lead time. This is coupled with a lack of clarity in the rules and related guidance, often until very shortly before (or after) the regime comes into force. This means that institutions struggle to implement a response and frequently the cost of implementation is many times higher because it is being completed in a ‘burning platform’, tactical environment rather than through adopting a more considered, strategic approach.

So, what should institutions be doing now?
In our experience, many institutions developed a ‘tactical’ solution to the French FTT, quickly amending systems and processes to deal with the regime at short notice. Very few institutions are preparing for the EU FTT regime because the focus so far has been preparing for domestic FTTs that are in force already or coming into force in coming months.

However, given the pace of developments in this area, and the number of FTTs expected over the coming months and years, in our view institutions need to take a more strategic approach in responding to these developments. Furthermore, any response should seek to leverage the work done already in responding to previous FTT regimes. The following sections of this document set out what we observe in the industry by way of responding to these developments and our recommendations for the practical steps institutions can be taking now.
FTTs impact a number of different areas of a financial institution from the front office trading strategies through to the clearing and settlement systems and processes. The level of impact in each of these areas will vary depending on the type of institution - broker, custodian, asset manager etc. For each of the areas of the organisation which are likely to be impacted, the table below summarises the key activities that will need to be undertaken by those functions in response, together with a summary of the main deliverables which will be required.

<table>
<thead>
<tr>
<th>Activities</th>
<th>Operations</th>
<th>Tax and legal</th>
<th>Technology</th>
<th>Risk management and compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determine how the FTT would impact trading strategies and the products</td>
<td>Assess the changes needed to current operations function activities and</td>
<td>Determine the role that the in-house tax resource will play in providing tax</td>
<td>Map existing systems from front-office booking to clearing and settlement</td>
<td>Define what risk management procedures are required to monitor compliance with FTT regimes and the extent to which any third party assurance is required.</td>
</tr>
<tr>
<td>that each desk/location/fund vehicle has a mandate to trade.</td>
<td>processes to cope with settling FTT across a diverse range of financial</td>
<td>technical input and in supporting constructive engagement with governments.</td>
<td>interface for all in-scope products.</td>
<td></td>
</tr>
<tr>
<td>Determine whether FTT costs will be recharged to end investors or the</td>
<td>instruments.</td>
<td>Review customer terms and conditions to determine whether the FTT can be</td>
<td>Review existing data fields to determine what additional information</td>
<td></td>
</tr>
<tr>
<td>extent to which these will be absorbed internally.</td>
<td></td>
<td>recharged to customers where appropriate.</td>
<td>should be held on counterparties and customers.</td>
<td></td>
</tr>
<tr>
<td>Assess the impact of FTT on market liquidity, product pricing and bid/offer</td>
<td></td>
<td>Prepare detailed memo setting out the technical analysis of FTT regime as</td>
<td>Assess third party vendor solutions for data feeds on legal entities, in-</td>
<td></td>
</tr>
<tr>
<td>spreads.</td>
<td></td>
<td>it will apply to the organisation.</td>
<td>scope securities and tax engines.</td>
<td></td>
</tr>
<tr>
<td>For products which are potentially subject to FTT review and identify the</td>
<td></td>
<td>Identify key areas of uncertainty in the application of the rules given its</td>
<td>Determine whether tax engines developed in-house for other FTT regimes can be adapted to cater for the new requirements.</td>
<td></td>
</tr>
<tr>
<td>booking locations.</td>
<td></td>
<td>business profile and trading activities.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Map the location of counterparties to in-scope financial transactions.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory of products, transaction types and the location of</td>
<td>Documentation of existing process flows for the operation functions at</td>
<td>Detailed memo setting out the technical requirements of the FTT regime.</td>
<td>Documentation summarising existing systems architecture.</td>
<td>Compliance model.</td>
</tr>
<tr>
<td>counterparties.</td>
<td>each stage of the transaction life-cycle.</td>
<td>Recommendation of the approach to amending existing customer terms and</td>
<td>Recommendations as to third party vendor solutions.</td>
<td>Internal audit review procedures.</td>
</tr>
<tr>
<td>Operating model for recharging FTT.</td>
<td></td>
<td>conditions.</td>
<td>Recommendations as to changes to systems architecture to capture additional</td>
<td>Controls documentation.</td>
</tr>
<tr>
<td>High-level model of impact across the product range.</td>
<td></td>
<td></td>
<td>data fields.</td>
<td></td>
</tr>
</tbody>
</table>

Financial transaction taxes
PwC
February 2013
What we observe in the industry

Our observations of industry practices
### Brokers and custodians

#### Governance
- Most brokers and custodians have put in place working groups in response to the French FTT and in anticipation of the Italian FTT.
- They have typically established working groups comprising subject matter experts from across the organisation, covering legal, compliance, tax, operations, front-office, and technology.
- Ownership generally sits with the business or operations in the location where the primary infrastructure supporting the impacted businesses sits.

#### Constructive Engagement with Government
- A number of industry groups have taken a very pro-active approach in trying to seek clarity on the application of the rules and putting in place contractual documentation to manage exposures where the law fails to clarify the position.
- On French FTT, consultation with governments has been primarily aimed at obtaining clarity on the application of the law for all the parties involved. Given time constraints, much of the discussion was undertaken after the commencement date in order to obtain clarity on the law and guidance issued.
- Debate on the EU FTT has been more focused on trying to demonstrate why the FTT would have adverse impacts at a macro-economic level.

#### Business Response
- Banks and brokers do not generally view the FTT as a direct cost since client agreements will typically provide for them to pass the cost on to the end client.
- Accordingly their response to the FTT developments has been to ensure that there are robust processes for ensuring compliance with the regimes, rather than changing how they conduct securities business to mitigate FTT costs.

#### Implementation
- Most brokers and custodians have taken a ‘tactical’ approach to implementation as a result of the very short lead times, primarily focusing on addressing the client interface first and ensuring that the FTT cost can be passed on to the client where appropriate.
- The other key area of focus has been on ensuring that the use of the various exemptions (e.g. market maker and securities financing exemptions) can be maximised.
- Significant reliance has been placed on industry groups to resolve uncertainties as to the detailed application of the requirements.
- Best practice seeks to leverage lessons learned from the experience gained from operating other transfer tax regimes – for example, UK SDRT, French FTT and Hong Kong stamp duty.
- Very few institutions have taken a ‘strategic’ approach in response to FTT developments, (1) seeking to develop a process which can be replicated for future regimes and (2) gathering information in a way which ensures that, for any future regimes, it is only necessary to consider what is different for that market.
Asset management

Governance • Given that the French and Italian FTTs place the tax collection and reporting obligations with the custodians and brokers, the asset management community has not typically established dedicated teams to focus in detail on operational implications of FTTs.

Constructive Engagement with Government • There has been engagement to date in connection with the EU Commission proposals. Those submissions that have been made focus primarily on the overall cost of doing business and exemptions that should apply in principle.

• Input (including the submissions made by the Dutch Government in connection with the Enhanced Cooperation Procedure) has emphasised the need for an exemption for pension funds and relief for units or shares issued or redeemed in UCITS.

• Another key issue for consultation on the EU FTT has been the potential for multiple charges to arise under a single transaction. This has been seen as inequitable and also arguably contrary to the public policy of encouraging saving by investors.

Business Response • For asset managers, FTTs will be a cost that will impact their expected performance on investment strategies.

• Certain FTTs (in particular the EU FTT) may act to charge funds distributing units (depending on the distribution model used) as well as fund investment activities. Accordingly, funds need to consider the impact on distribution strategy as well as the impact on investment strategy.

• Consequently we have seen the asset management industry seek to identify the impact of the various FTTs on their business and establish a response to limit the cost of the tax by engaging in constructive discussion for changes.

Implementation • The primary focus for the asset management sector has been on assessing the business impact of domestic FTTs, given the additional transactional costs associated with doing business.

• As a result of the narrow scope of the netting rules in recent FTTs, asset managers have been looking at the impact of transacting across different brokers. Under the French FTT, there is no ability for a fund to net positions in relation to a particular security across different brokers. This arguably creates a tension with the requirement under the AIFMD regulatory regime to select brokers based on best execution capability.
A framework for response

Our recommended approach to the issue
Financial institutions need to adopt an integrated strategy, recognising that there is likely to be significant overlap in the scope of the domestic FTTs and the EU FTT

Financial institutions need to start considering their approach to preparing for FTTs now. In our view they should look to obtain synergies from the work they undertake in response to domestic FTTs to minimise the amount of re-work required in the event the ECP is successful.

In order to respond to the challenges posed by FTTs, financial institutions need to adopt an integrated strategy, recognising that there is likely to be significant overlap in the scope of the domestic FTTs and the EU FTT.

The integrated strategy should include the following key elements (see Figure 5):

- An impact assessment of FTT across all lines of business;
- A strategic response, based on the results of the impact assessment, covering the following areas:
  - Constructive Engagement with Government
  - Business Response
  - Implementation

The strategy needs to be supported by an appropriate governance model to:

- Manage changing rules
- Ensure key messages are conveyed to governments, and
- Develop an approach to preparing for changes to operational systems and processes, and to facilitate required changes to the business strategy.

When should this work begin? In our view there are good reasons for launching a strategy now, including the following:

- With the shape of the EU FTT to be debated among the participating countries in the coming months, now is the time to engage with governments and provide input on the design of the regime.
- More domestic FTTs may take effect in the short term. The Italian FTT comes into force on 1 March 2013.
- Given the complexity and scale of the business operated by financial institutions, a full impact assessment is likely to require careful planning and sufficient time for analysis.

However, these points need to be balanced with the following considerations:

- As new regimes are announced, there will inevitably be some replication of work in performing subsequent impact assessments. For this reason, to the extent possible, institutions should seek to capture data likely to be relevant for all regimes as part of the first impact assessment and seek to leverage this in future exercises.
- The final shape of a number of future FTT regimes (including the EU FTT) is not yet certain, which means that work on a detailed business response and implementation is not yet possible. However, the impact of future regimes can still be assessed based on what is known at this stage and certain assumptions about the final end state.
For many institutions, there is currently a need to respond specifically to the Italian FTT. In doing so, many are considering how to build on the work already undertaken in preparing for the French FTT.

In our view, the implementation of the Italian FTT presents an opportunity to start gathering the information required to assess the impact of further domestic FTTs and/or the EU FTT, and to build the governance framework in anticipation of these regimes. This is because there will be certain features of existing regimes that will be replicated in future regimes.

To illustrate this conceptually, the various domestic FTT proposals and the EU FTT model can be viewed along a spectrum, with ‘narrower scope’ FTTs, closer to the UK SDRT model, at one end of the spectrum and ‘wider scope’ FTTs, such as the current EU FTT proposal, at the other end (see Figure 6). This reflects the key attributes of FTT regimes that need to be considered.

An impact assessment can therefore use a ‘building blocks’ approach – building on knowledge of the impact of existing FTT regimes and seeking to identify commonality between the existing and future regimes, thereby enabling previous impact assessment work to be re-used. This approach ensures that those areas that are most likely to be in scope under a new FTT are prioritised as part of any implementation work.

Following this process, the impact of those aspects of new FTT regimes which differ from existing FTTs can then be reviewed. The results of this review can then be used as a starting point for the review of other FTT regimes which are yet wider in scope.

**Figure 6: The spectrum of FTT regimes**

- **UK SDRT**
  - Tax based on location of securities
  - Few instruments in scope
  - Few transactions in scope
  - Exemptions, e.g. market maker relief
  - Single charge

- **French FTT**

- **Italian FTT**

- **Final EU FTT?**
  - Tax based on location of parties
  - Many instruments in scope
  - Many transactions in scope
  - Few exemptions
  - Purchaser and seller liable

- **EU FTT proposal**
Turning to the lessons learned from the French FTT in particular, many institutions impacted by new FTTs have already had to deal with the French regime. In light of the approach set out on the previous page, in order to implement an efficient strategy for managing future FTTs it is therefore of critical importance to maximise the benefits of the lessons learned from preparing for the French tax. These lessons can be used to focus resources for implementation, enable effective communication of key messages and help to inform any adaptation of business strategy.

The table sets out what we consider to be the key issues from the French FTT experience for financial institutions to learn from.

<table>
<thead>
<tr>
<th>French FTT challenges</th>
<th>Learning for future FTTs</th>
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</table>
| Lack of clarity in the rules and guidance | • Need to look for areas of commonality among regimes  
• Consider compiling list of key issues likely to be relevant – this will help in planning ahead and developing responses (key issues include the scope of any market maker exemption, the types of products covered, impact of netting arrangements, etc.) |
| Need for constructive engagement | • By developing a list of key common issues and engaging at an early stage with local tax authorities, institutions will be best placed to ensure that future regimes are implemented in a practical way |
| Importance of developing a strategic response | • FTT renders trading in taxed instruments less attractive, thus business cases for activities in such instruments need to be reviewed, in particular for those cases where margins are tight already  
• Depending on the results of the business case analysis, trading strategies and asset allocation need to be reviewed  
• Where trading in taxed instruments is offered as a service to customers (e.g. brokers trading on behalf of asset managers), the contracts with the customers must be reviewed (on pricing, at a minimum); business relations might be re-defined or even given up |
| Importance of understanding the underlying business from a product, operational, and legal perspective | • Requires the assembly of a combined team with representatives from the business, operations, IT and Tax and Legal in particular  
• Across this team issues to be considered include products traded, identity of counterparties, legal entities involved, interaction between desks, how transactions are cleared and settled, etc. |
| Importance of legal documentation | • Necessary to have a clear understanding under existing legal documentation as to who will bear the cost of FTT, requiring a review of existing terms and conditions with customers and counterparties  
• In particular, review agreements to determine accountability where there are chains of brokers |
We now turn to the practical steps required as part of the integrated strategy set out on page 16. The impact assessment underpins this strategy. It is the foundation of the governance structure, the constructive engagement strategy and identification of the operational challenges for implementation and allows timely formulation of business strategy.

The assessment needs to use a structured methodology comprising a ‘top-down’ analysis of tax technical requirements coupled with a ‘bottom-up’ analysis of the business transactions and processes. This provides the best chance of obtaining a complete picture of how an FTT regime will impact across the organisation. The four key phases are set out below.

1. **Scoping and kick-off**
   - To keep the impact assessment focused and resource used effectively and efficiently, this initial phase confirms scope with key stakeholders and sponsors.
   - A series of targeted workshops can be run to confirm the list of businesses, products, and systems that are expected to be in scope.
   - A plan is developed for the impact assessment, including FTT team structure, roles, and responsibilities.

2. **Requirements analysis**
   - With FTT regimes in a state of flux we can expect many new amendments and details to be introduced.
   - This phase will be on-going throughout the project work and will involve monitoring any changes and updates to make sure all the latest developments are captured and considered.

3. **Current state assessment**
   - Through the current state assessment, the aim is to identify the key attributes such as transactions, products, counterparties, processes and systems which will be affected by the implementation of the change in legislation.

4. **Gap analysis and implementation planning**
   - The gap analysis aims to identify gaps between the current state assessment performed in phase 3 and the requirements analysis from phase 2, and understand and prioritise changes by establishing a strategic roadmap alongside detailed technical specifications.
The structure will evolve during the various phases of the programme as its objectives change. That said, the key focus areas for governance will remain as follows:

- Engagement strategy and impact assessment: ensure the high-impacted areas are mobilised to focus the attention on the business and territories where the most effort is expected to be required, and develop the implementation approach.
- Implementation: ensure that adequate progress is made by all impacted parties, and coordinate the various FTT responses (if more than one has to be delivered simultaneously).
- Ongoing maintenance: whilst embedding compliance into business-as-usual activities, monitor for new products and new taxes to inform key stakeholders and anticipate changes.

Turning to the governance structure, setting up the right governance is critical to ensuring that the key stakeholders across the institution are involved, kept up to date with latest developments, drive the implementation and report on progress. In addition, close coordination should be in place with the other key regulatory/change programmes to manage synergies and share resources where relevant.

A Global Steering Committee overseeing the implementation of all relevant FTTs should be in place, and could be constituted as follows:

- Overall governance/decision-making authority, providing program oversight, direction, resources/funding and approval
- Track the developments of FTT in all relevant jurisdictions and inform the Steering Committee and relevant parties
- Constituted of tax experts to understand the rules and Operations/Change specialists to derive the operational impacts
- Coordinate the activities across the various working groups and ensure timely communication to all stakeholders
- Track progress across the different FTT regimes and different locations and coordinate analysis and implementation
- Representation from key regions (and key relevant territories), key functions and all impacted businesses is essential to consistent and effective constructive engagement and implementation

Global Steering Committee (All FTTs)

- FTT monitoring and design team
- Regional coordination
  - APAC
  - EMEA
  - Americas
- Functional representation
  - Tax
  - IT
  - Operations
  - Finance
- Business representation
  - Investment Bank
  - Asset Mgt
  - Wealth Mgt
  - Retail
  - Custodian
1. **What issues should be focused on?**
   - Identification of the provisions to be focused on should begin with identification of the areas of difficulty arising from:
     - Past FTTs (e.g. Hong Kong Stamp Duty, UK SDRT);
     - Recently in force FTTs (e.g. French and Italian FTT); and
     - Proposed FTTs (e.g. EU FTT).
   - Figure 7 below sets out the key areas that we will expect to be of interest to financial institutions.

2. **Who should be engaged?**
   - In our view, the most effective and constructive engagement with government will be that which seeks to inform the policy intent with practical input/experience (e.g. limiting the instruments in scope, etc.) rather than arguing against an FTT in its entirety.
   - Our experience with the French and Italian FTTs is that the most effective and constructive engagement has been indirect debate via the local industry bodies (e.g. AMAFI, AFTI, etc.).
   - With respect to the EU FTT, it would be most productive to liaise with governments implementing the FTT as they will be closest to the EU FTT implementation issues in their countries.

3. **When should constructive engagement start?**
   - The time for constructive engagement is now.
   - With a stated start date of 1 January 2014 for the EU FTT, it is essential that any engagement starts as soon as possible to have the best chance possible of shaping the EU Commission’s proposals.
   - Similarly, engagement with government bodies on the other proposed FTTs (e.g. Spanish, Portuguese, etc.) should be undertaken as soon as possible to have effective impact.
   - Consultations or discussions should not be limited to the proposed FTTs as the guidance and practice around in-force FTTs (e.g. Italian, French, etc.) remains in its infancy. The guidance and practice will have practical implications so it is important that discussions with local tax authorities take place to reach the right outcome. As with the proposed FTTs, the quicker this process is undertaken the more effective it will be.
As with the other components of the strategy, this will be driven from the results of the impact assessment.

For a given FTT regime, a key factor that will drive the type of business response available will be whether the FTT operates a 'residence model' or an 'issuance model':

- **Residence model** – the FTT is levied by reference to the location of the parties to the transaction (e.g. the original draft EU FTT released in September 2011).
- **Issuance model** – the FTT is levied by reference to the location of the issuer of the securities being traded (e.g. the French and Italian FTTs).

Turning to the Business Response component of the integrated model, this centres around potential adaptations to an institution's business model in response to the impact of FTTs. Such business and operational planning could range from minor changes to trading models in response to the cost of the tax, through to abandoning businesses that are rendered nonviable by the additional cost of FTT regimes.

Depending on which model a given FTT falls into, the impact on the business model and investment strategy for financial institutions will vary. The table below sets out examples of some of the business response techniques that might be adopted, depending on whether the FTT follows a residence model or an issuance model.

### End investor considerations

<table>
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<th>Residence model (e.g. original draft EU FTT Directive)</th>
<th>Issuance model (e.g. French and Italian FTTs)</th>
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<td><strong>Portfolio changes</strong></td>
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<td>- FTT charge will arise regardless of the market in which financial instruments are issued. The incidence of tax will therefore depend on the type of instrument traded (e.g. equities or equity derivatives)</td>
<td>- Incidence of tax will depend on the market in which the instrument is issued. It may also depend on the type of instrument traded (e.g. equities or equity derivatives) depending on the precise structure of the regime</td>
</tr>
<tr>
<td><strong>Transaction counterparty</strong></td>
<td></td>
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<tr>
<td>- Trading with counterparties inside the FTT zone will give rise to FTT charges, whereas transactions with counterparties outside the FTT zone will not</td>
<td>- Transacting over taxable instruments will give rise to a FTT charge regardless of the counterparty, so the focus will instead be on who bears the economic cost under the contractual terms</td>
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<tr>
<td><strong>Trade Infrastructure</strong></td>
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<tr>
<td>- Transactions may or may not be subject to FTT, depending on the group company which enters into the transaction and whether or not it is treated as established in the FTT zone</td>
<td>- Potential to net purchase and sale transactions, depending on the provisions of the regime (this may involve using a single broker for purchase and sale transactions)</td>
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</tbody>
</table>
The extent to which this is an issue only for brokers and custodians, and whether other types of institutions need to consider this, will depend on the form of the regime. This is considered on the following page.

Through the mapping exercise, the institution needs to build an understanding of:

- booking entity and account structure
- the clearing model used for transactions
- process and systems interfaces
- interaction between front-end systems and the clearing and settlement process
- location of infrastructure supporting the business
- interaction between desks

The implementation phase is focused on the practical steps required to deal with FTTs on an ongoing basis, including systems requirements, reporting and payment processes, infrastructure requirements, etc.

For each product within scope of the FTT, an exercise needs to be undertaken to map the existing systems and processes in order to identify the changes that will be required to enable the requirements of each respective FTT (domestic and EU FTT) to be met. An example systems map that might be developed in a banking context is set out in Figure 8 below.

**Figure 8: An example systems map for a banking institution**
However, whether this will be the case for future FTTs depends on the precise form of the FTT. Conceptually, this point can be illustrated by reference to the FTT spectrum introduced previously in this document (we have reproduced this below in Figure 9).

For a new FTT which is narrow in scope, closer on the spectrum to UK SDRT, we can expect the operational burden to fall primarily on brokers, custodians and settlement venues.

A wider scope FTT, however, may give rise to multiple charges for a number of financial institutions involved, and place the FTT liability on each such institution (indeed, this is the approach of the current draft EU FTT).

For such a regime, therefore, the operational burden could be expected to fall on end investors, as well as brokers, custodians, etc.

Accordingly, if it is concluded as part of the impact assessment that the regime under review is very wide in scope, institutions such as asset managers will need to be much more focused on operational requirements as part of the implementation phase than they would be for a narrow scope FTT. Issues such as whether infrastructure needs to be developed in-house or whether third party service providers are engaged for operational processes will need to be considered carefully.

Figure 9: The spectrum of FTT regimes

Increasing operational impact for end investors

UK SDRT
- Tax based on location of securities
- Few instruments in scope
- Few transactions in scope
- Exemptions, e.g. market maker relief
- Single charge

EU FTT proposal
- Tax based on location of parties
- Many instruments in scope
- Many transactions in scope
- Few exemptions
- Purchaser and seller liable
How PwC can help

Our capabilities and tailored approach
We have worked on a number of engagements assisting clients with preparing for the French FTT. We also have a long history of advising institutions on existing FTTs, such as the UK SDRT and Hong Kong stamp duty.

With this experience we have developed an approach to help clients prepare for FTTs to come in the future. This approach is sufficiently structured to ensure that all affected transactions and projects are captured, but flexible enough to respond to regimes that in many cases are not yet finalised.

The key features of our approach are set out below.

**A single team combining tax technical expertise with industry knowledge**

Our FTT network comprises a team that brings together industry knowledge, operational expertise, and tax technical specialists. This allows us the best chance of identifying all of the products, transaction configurations, and business lines that will be impacted by FTTs and addressing the operational implications at an early stage.

Our experience working with a number of existing FTTs, including the French FTT, allows us to identify the scenarios that commonly give rise to charges under FTTs.

We have extensive experience in wider operational taxes matters, such as FATCA, for example.

**A structured approach which can be replicated**

We have developed a structured approach comprising a ‘top-down’ analysis of tax technical requirements coupled with a ‘bottom-up’ analysis of the business transactions and processes.

**A global network with FTT technical and consulting specialists in each jurisdiction**

We have developed a network of FTT specialists across Europe, with representation in all countries with a domestic FTT and all countries involved in the ECP process. Each jurisdiction includes a tax specialist and a consulting specialist so that we can cover the tax technical and operational side of any new regime.

Our team members frequently have relationships with local industry groups and tax authorities to provide an avenue for constructive engagement with governments.
“How PwC can support the integrated strategy”

FTT Impact assessment
- Assist in workshop and/or questionnaire design
- Briefing and training for the business
- Facilitate workshop
- Advise on technical requirements
- Undertake gap analysis
- Document current systems and processes
- Project management

Governance
- Reviewing governance structure, benchmarking, and providing PMO support where required

Engagement with governments
- Helping to devise the message and strategy around the engagement with government
- Alongside industry and other professional organisations, we can bring our specialist technical expertise to bear on issues subject to consultation.
- Using links to industry bodies

Business Response
- Technical input to identify the FTT consequences of proposed changes to the business strategy and model

Implementation
- Reviewing tax calculation logic and decision trees
- Reviewing changes to systems architecture
- Developing testing procedures
- Pilot testing
- Reviewing third party vendor solutions
Network established comprising specialists across all 11 enhanced cooperation procedure jurisdictions and all domestic FTT locations. Regular communication across the network to share latest information.

Local contacts available to your business globally

Network comprises tax and consulting specialists. 
PwC capability to assist you on strategic response, governance, systems and processes aspects as well as tax technical input

Network includes individuals closely involved in discussions around the scope of domestic and EU FTTs. 
This ‘inside track’ will provide you with the very latest position as the legislation and practical implementation of FTT regimes evolves

### PwC Global FTT network

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<th>Country</th>
<th>Local contacts – Tax and advisory</th>
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“We have established a strong network of Tax and Advisory experts across Europe to monitor the development of FITs. They regularly issue newsflashes and webcasts to update our clients and our teams.”
Appendix – the EU FTT

The latest draft Directive for the EU FTT was released on 14 February 2013. The key aspects of the proposed regime are set out in this Appendix.

This page and the four pages that follow focus on the scope of the charge. We then turn to other aspects of the regime including the rates of tax and exemptions from the charge.

The Directive applies to ‘...all financial transactions, on condition that at least one party to the transaction is established in the territory of a participating Member State and that a financial institution established in the territory of a participating Member State 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’ [Article 3]
Financial transactions are any of the following:

- Purchase and sale of a **financial instrument**
- The transfer between group companies of the right to dispose of a **financial instrument**
- Conclusion or modification of derivative contracts
- Exchange of **financial instruments**
- Repo, reverse repo and stock lending agreements

Financial instruments:

All instruments in Section C, Annex I of Directive 2004/39/EC, which include the following:

- Transferable securities (including equity and debt securities)
- Money market instruments
- Fund units
- Options, futures, swaps, forwards and other derivatives over commodities, currencies, indices and various other assets/prices (whether physically settled or cash settled)
- Credit default swaps
- Financial contracts for differences (“CFDs”)
- Structured products

Comments: the draft Directive applies to a very wide range of transactions, over a very wide range of financial instruments
A financial institution is established in a jurisdiction in any of the following cases:

- It is authorised by authorities in that jurisdiction
- It is authorised or entitled to operate in that jurisdiction from abroad
- It is incorporated in that jurisdiction
- It has a permanent address or usual residence in that jurisdiction
- It has a branch in that jurisdiction (for transactions carried out by that branch)
- It is party to a transaction (as principal or agent) with another party ‘established’ in that jurisdiction
- It is party to a transaction (as principal or agent) in financial instruments issued in that jurisdiction

Comments: under the draft Directive, financial institutions can be ‘established’ in a jurisdiction (and therefore subject to EU FTT in that jurisdiction) in many ways. In particular, a financial institution with no nexus with a country in the FTT zone can still be taxable in that country by trading with a counterparty in that country (the ‘residence principle’) or by trading instruments issued in that country (the ‘issuance principle’)
Appendix – the EU FTT

The participating Member States are those that have signed up to the Enhanced Cooperation Procedure. Currently, these are the following countries:

- Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, and Spain
- Other countries may join the Enhanced Cooperation Procedure at any time during this process.

Comments: in assessing the impact of the EU FTT, the focus will need to be on operations conducted in these 11 countries, transactions with counterparties in these countries, and transactions involving financial instruments issued in these countries.
A financial institution is any of the following (each of which is defined by reference to existing EU regulations):

- An investment firm
- A regulated market and similar trade venues
- A credit institution
- An insurance or reinsurance enterprise
- A UCITS fund or management company
- A pension fund or vehicle, and the manager of such an enterprise
- An alternative investment fund, and the manager of such a fund
- A securitisation SPV
- A special purpose vehicle
- Other institutions which carry out certain activities, including lending, financial leasing, providing guarantees, holding subsidiaries and issuing financial instruments (provided more than half of annual turnover comes from financial transactions)

Comments: this definition is sufficiently wide to bring most participants in the financial services sector in scope. Also within scope are other institutions which might consider they operate outside of the FS sector (such as group treasury companies or group holding companies, depending on levels of turnover)
### Appendix – the EU FTT

Having determined the scope of the tax, we set out below the other key aspects of the FTT regime under the draft Directive.

<table>
<thead>
<tr>
<th>Feature</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liability for the tax</strong></td>
<td>• For each financial transaction, FTT shall be payable by each financial institution which is party to the transaction&lt;br&gt;• Each party to a transaction is jointly and severally liable for payment of the tax if it is not paid within the time limit</td>
</tr>
<tr>
<td><strong>Rates of tax</strong></td>
<td>The rates will be set by each participating Member State. The rates shall not be lower than:&lt;br&gt;• 0.01% for derivative transactions (calculated based on the notional value of the derivative)&lt;br&gt;• 0.1% in respect of other financial transactions (calculated based on the value of the consideration, or market value if higher)</td>
</tr>
<tr>
<td><strong>Exempt transactions</strong></td>
<td>Very few. The following transactions are exempt:&lt;br&gt;• Primary market transactions&lt;br&gt;• Transactions with certain bodies, including central banks, the EU and certain national bodies&lt;br&gt;• Certain group restructuring transactions&lt;br&gt;Significantly, no exemptions for market makers, intra-group transactions, stock loan or repo transactions.</td>
</tr>
<tr>
<td><strong>Exempt parties</strong></td>
<td>Exemptions provided for the following:&lt;br&gt;• Central counterparties&lt;br&gt;• Central Securities Depositories and International Central Securities Depositories&lt;br&gt;• Member States and associated public bodies</td>
</tr>
<tr>
<td><strong>Payment and reporting</strong></td>
<td>• Payment is due instantly for transactions carried out electronically, or within 3 days in other cases&lt;br&gt;• Each party liable to pay FTT is required to submit a return to the tax authorities on a monthly basis</td>
</tr>
<tr>
<td><strong>Proposed start date</strong></td>
<td>• 1 January 2014</td>
</tr>
</tbody>
</table>