The EU financial transactions tax: unprecedented steps

Global FS Tax Newsflash

July 2012

This is the fourth in our series of Newsflashes regarding the proposed introduction of a Financial Transactions Tax (FTT) within the EU. Following the recent ECOFIN meeting and EU summit, it now appears likely that the huge political force behind the proposals will result in a FTT being implemented in a number of European countries through the EU's enhanced cooperation procedure. The use of this procedure to introduce new taxes is unprecedented. In this bulletin we set out the very latest position across the EU and provide our thoughts on what shape any FTT may take.

ECOFIN

At the ECOFIN meeting on 22 June, EU Finance Ministers held a debate on the European Commission's proposed FTT Directive and a Danish EU presidency paper. This paper set out alternative ways forward on the FTT project – either the introduction of a FTT on a 'two step' basis (i.e. introduction of a narrow form FTT, followed in due course by a wider scope FTT), or examining other possible ways of regulating or taxing the financial sector.

The presidency concluded that support for the FTT as proposed by the Commission was not unanimous. However, it also noted that a significant number of delegations supported the idea of enhanced cooperation, which would allow introduction of a FTT across a subset of the EU. The next steps in the process would need to be handled by the incoming Cyprus presidency, which will hold the role from 1 July 2012 to 1 January 2013.

EU summit

At the EU summit on 28 and 29 June, EU leaders agreed that the FTT proposal will not be adopted by the Council (i.e. all 27 EU Member States) within a reasonable period. It was announced that several Member States will therefore launch a request for enhanced cooperation on a FTT, with a view to adoption of a FTT regime by December 2012.

What does this mean?

Following these two meetings, it is now clear that the Commission's original proposal from September 2011 for a very broad scope EU-wide FTT is off the table. This will be a relief to many in the financial services sector.

The focus now turns to which countries will seek to introduce a FTT via enhanced cooperation, whether the conditions (which are discussed below) for the enhanced cooperation procedure can be met and the precise shape of any FTT ultimately introduced.

Other developments

In parallel to these EU-level developments, the unilateral French FTT becomes effective on 1 August 2012 (for the very latest position on the French FTT, please refer to the recent bulletin produced by Landwell France[1]).

However, since President Hollande of France is strongly in support of a European FTT, the enhanced cooperation procedure could result in France ultimately introducing a new form of transaction tax very soon after the financial services industry has made final preparations for the current version.

[1] The bulletin can be accessed at the following link: http://www.landwell.fr/french-financial-transaction-tax-on-equity-securities-latest-developments-and-practical-implications-for-the-market.html

Enhanced cooperation and the position of Member States

The use of enhanced cooperation to introduce tax law within the EU is unprecedented. This indicates the very strong political will in certain EU Member States, and in the European Parliament, behind the introduction of a FTT.

Enhanced cooperation has only been used twice in recent years: in relation to EU divorce law and EU patent law. Given that the process is untested in tax law, we understand that there is currently some uncertainty within the EU institutions as to the precise procedure to be followed to adopt a FTT.

The legal basis in the EU Treaties for enhanced cooperation is Article 20 of the Treaty on European Union and Articles 326-334 of the Treaty on the Functioning of the European Union. Enhanced cooperation allows a number of Member States to use the EU's institutional framework to move ahead faster than some other Member States to further the objectives of the Union, protect its interests and reinforce its integration process. Such cooperation is open at any time to all Member States.

Enhanced cooperation can only be adopted by the Council as a last resort – it is necessary to establish that the objectives of such cooperation cannot be attained within a reasonable period by the EU as a whole and it is also necessary that at least 9 Member States support the proposal. In addition, enhanced cooperation requires a qualified majority vote in Council by all 27 EU Member States in order to proceed; this means that the 9 or more Member States in favour of the proposal must represent 70% of the total EU population. The proposal would only be implemented in, and be binding on, those Member States adopting the proposal.

Any authorisation to proceed with enhanced cooperation (which would ultimately be granted by the Council, after obtaining the consent of the European Parliament) would require a proposal from the Commission. We understand that a draft letter outlining the scope and objectives of an alternative FTT proposal, prepared by the German-led FTT working group, was recently sent to the 9 Member States that had previously announced their support for the EU FTT to the Danish Presidency on 7 February 2012 (i.e. Austria, Belgium, Finland, France, Germany, Greece, Portugal, Spain and Italy).

We understand that the draft proposal will now be refined to reach a compromise proposal for a FTT via enhanced cooperation that is acceptable to all Member States which support the process. As a next step, the new proposal will need to be acceptable for the Commission.

The 9 Member States in favour do not represent 70% of the EU's total population (accounting for only 59.6%), so the qualified majority threshold cannot be met by these States alone. However, other EU Member States are also believed to be following this process very closely. We understand that a further 6 Member States have also been sent the letter by the FTT working group: Cyprus (probably only because it currently holds the EU's presidency, as it has been opposed to a FTT from the start), Estonia, Lithuania, Malta (opposed the broad, EU-wide FTT), Slovenia and Slovakia.

Hungary is also understood to be a supportive country and recently introduced a FTT unilaterally. Even with the support of Hungary and these 6 additional Member States, the required qualified majority threshold would not be achieved: 64.3%.

These scenarios are illustrated in the diagram on the following page.

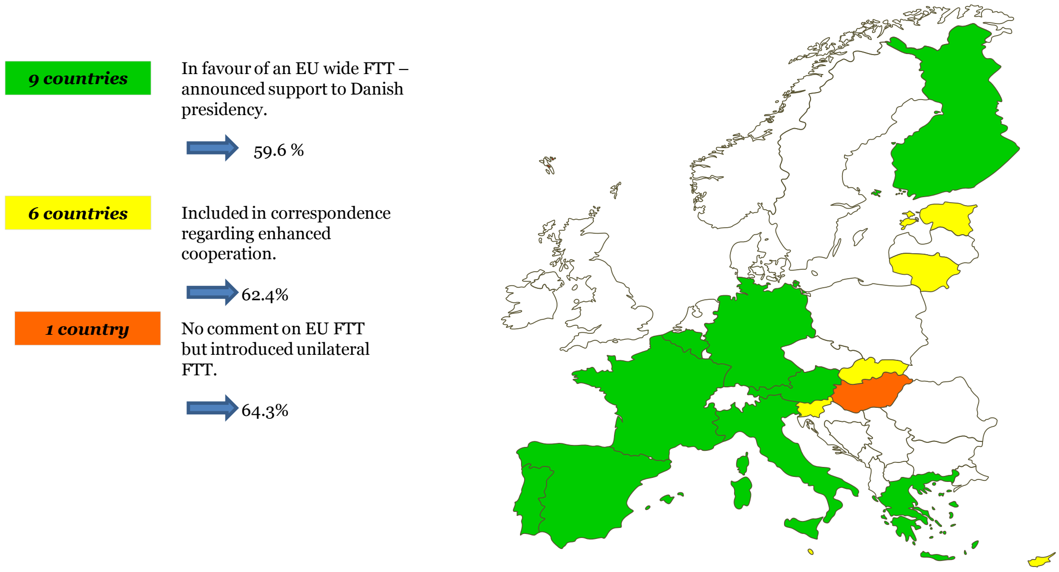

Illustration shows percentage of EU population- it represents the current status of the FTT implementation via enhanced cooperation.

Clearly, the participation of further (population-dense) Member States will be necessary for the process to proceed. In particular, the support of Poland, with its population of 38m, could yet be crucial. Although Poland is currently not part of the process, it is closely following the latest developments and we understand it is awaiting the final version of the FTT to announce its official position. Despite not expressing an intention to be part of the special FTT working group, Poland has supported initiation of the enhanced cooperation procedure.

In summary, we can now expect those countries in support of the FTT, led by Germany and France in particular, to try to assert their influence over other Member States in the coming weeks and months with a view to reaching the qualified majority threshold.

Shape of the new FTT model

As yet, the shape of any FTT to be introduced by enhanced cooperation remains unclear, although we expect a final version to be ready very shortly.

That said, at this stage a likely outcome would appear to be a two-stage model, comprising a narrower form FTT followed at a later stage by a FTT more akin to the original Commission proposal – but both would still be part of one and the same legislative proposal, which would also be unprecedented. The intention of such a model would presumably be to implement a relatively narrow regime that is acceptable to all participating Member States as an interim measure, whilst retaining a wide scope FTT, along the lines of the original Commission proposal, as the ultimate goal.

The scope of any 'first step' model is unclear, but could conceivably be wider than a tax on equity transactions, potentially covering derivatives, currency trading and bonds. We understand that discussions are ongoing regarding possible exemptions for pension funds and private investors, and the mechanisms required to ensure that no damage is done to the 'real economy' as a result of introducing the tax.

What can you be doing now?

As we had predicted in previous bulletins, the introduction of some form of FTT within part of the EU now looks highly likely.

The discussions around the FTT continue to move at pace, so it will be essential to keep up to date with the very latest developments. We have set out below some of the key dates to watch before the end of this year.

July - imminent	Council letter to Commission: scope and objectives of the enhanced cooperation proposed.
July – August	Commission submits new FTT proposal to Council for enhanced cooperation
9 October	ECOFIN orientation debate on FTT
4 December	Possible ECOFIN vote
14 December	EU leaders summit

All the main financial services players – banks, asset managers, hedge funds, insurers, venture capitalists, pension funds – have significant 'skin in the game'. Each could legitimately be pressing for special treatment/ exemptions.

The 'perimeter' of the FTT is also a key issue. Questions arise such as:

- Will market makers get exemptions?
- Will 'not-for-profit' organisations or pension funds get special carve outs?
- How will non FTT-zone financial services players be caught?
- How can fund managers avoid double charges that can arise first on the issue of shares or units and then on the investment?

In this formative stage, it is vital that interested parties make their case.

As the shape of any new FTT emerges, it will be important to assess the impact of the proposals on your business, including which locations and business lines are most likely to be affected. The precise scope of the tax will be critical in this regard. For example, a tax on securities that applies by reference to the location of the security issuer could affect any company that trades securities issued in the 'FTT zone', even if the company itself has no operations in countries that introduce the tax.

Having performed an impact assessment, this can then be used to shape strategies for lobbying on the final shape of the proposals. For example, if a stamp duty style model is to be introduced some form of market maker exemption will be important to any companies trading securities within scope of the tax.

An impact assessment will also assist with preparing for any FTT ultimately introduced. What is clear from the introduction of previous examples of transaction taxes, including the new French FTT, is that those companies affected will need to move quickly to prepare for the new regime.

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:

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