

Legal challenge to the EU FTT – what happens now?

Global FS Tax Newsflash
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On Thursday last week, the UK launched a legal challenge against the EU Financial Transaction Tax (“FTT”). The UK has now received support for its challenge from Luxembourg, which publicly supported the UK’s position on Monday. In this Newsflash we set out the background to this challenge, its implications for the EU FTT and what institutions affected by the EU FTT should be doing now.

The UK’s legal challenge

On Thursday last week, the UK Government lodged an application at the Court of Justice of the European Union (“CJEU”) to challenge the EU FTT.

Whilst the basis of the challenge has not been made public, we understand that the UK is challenging the use of the Enhanced Cooperation Procedure (“ECP”) to introduce the EU FTT. Under this procedure, the European Council granted permission for the eleven interested Member States to introduce the EU FTT within those Member States.

Member States had a deadline of 12 weeks, beginning with the publication of the Council’s ECP authorisation decision in the Official Journal of the European Union, to mount a legal challenge with the CJEU. The Council’s decision was published on 25 January 2013, so the UK’s challenge may be seen as a defensive measure to protect the UK’s position as the EU FTT proposal moves forward.

The UK Government was also under pressure from the UK House of Lords to respond to the EU FTT developments. The European Union Committee of the Lords was critical of the UK Government’s position with respect to the EU FTT in a

recent letter¹ and called on the Government to engage on the topic as a matter of urgency, including taking “...urgent legal advice on the case for a legal challenge [against the use of the ECP] at the European Court of Justice.”

In mounting this challenge, the UK Government voiced concerns in particular with the extra-territorial scope of the proposed EU FTT. Under the proposal, a financial institution with no presence in any of the eleven Member States could still be brought within the scope of the tax where it enters into a transaction with a counterparty in one of the eleven participating States, or where it enters into a transaction over a financial instrument issued in one of the eleven States.

Does this mean the end of the EU FTT?

Whilst the motives of the UK Government are currently unclear, it appears that the Government is seeking to obtain changes to the structure of the proposed EU FTT regime, rather than to derail the proposals entirely (the Chancellor of the UK

¹ The letter can be accessed at the following link:
www.parliament.uk/documents/lords-committees/eu-sub-com-a/FTTEnhancedScrutiny/260313FTT.pdf

Government noted he was not against financial transaction taxes in principle).

Furthermore, the Commission remains of the view that the EU FTT proposal is legally sound.

There is some precedent for challenge to the use of the ECP; in the context of unitary patents, Italy and Spain challenged the use of the procedure by all other Member States. In AG Bot's opinion on this matter, which was delivered last year, it was found that the power of the CJEU was limited to reviewing whether the Council had made a manifest error, misused its powers or manifestly exceeded the bounds of its discretion. This is a very high threshold and arguably, therefore, unlikely to be failed in the case of the FTT process. Also, the CJEU can be expected to be reluctant to overturn a political decision made after a formal vote was taken in the ECOFIN Council.

For the reasons above, it appears unlikely that the UK's legal challenge will directly result in the proposal being abandoned. Nevertheless the UK's challenge, at this stage of the Member States' negotiations, may increase the pressure on the Member States to reduce the scope of the currently wide-reaching draft Directive. Furthermore, non-participating Member States will also have an opportunity to present a legal challenge to the new EU FTT Directive once it comes into force.

In terms of next steps in the process, the Member States will continue to discuss and debate the draft Directive released by the Commission in February 2013. The most recent meeting took place on 16 April.

We understand that progress at the meetings is slow, with stark disagreement between the eleven participating Member States, as well as the other Member States, on the final structure of the regime. The next technical level meeting among the EU-27 is due to take place in May, with the Irish Presidency of the EU due to report to the ECOFIN Council and European Council in June.

In summary, the action taken by the UK (and subsequently supported by

Luxembourg) is unlikely to result in the EU FTT being derailed. That said, the difficulties emerging in the negotiations between the Member States suggest that the proposed start date of 1 January 2014 remains highly ambitious.

It should also be noted that, notwithstanding the UK's challenge which is in part at least around extra-territoriality, the UK itself could be said to have a transaction tax that is extra-territorial in charging non-UK residents to stamp duty reserve tax, even if they have no presence in the UK (indeed, the UK Chancellor recognised that the UK has its own form of FTT when he announced that the UK had made the legal challenge).

What should institutions be doing now?

For the reasons set out above, in our view it would not be wise to assume that the EU FTT proposal will fail. Indeed, even if it does so we would expect more countries to introduce domestic FTTs, following the lead of countries including France and Italy.

Accordingly, institutions need to see FTTs as part of the tax landscape for the foreseeable future and they need to plan for this.

In terms of the practical actions to take, institutions should continue to monitor the developments in the EU FTT proposals. As negotiations continue between the Member States over the coming months, more clarity will emerge on the design and timeframe for introduction of the final regime.

In addition, we recommend that institutions continue to assess the impact of the proposals on their business operations. By understanding, at least at a high level, the financial cost of the FTT and the drivers of that cost, an institution is better placed to pro-actively engage with governments on the EU FTT regime and to consider the strategic implications for its business model.

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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