EU FTT – Will the Commission's proposal survive?

Global FS Tax Newsflash

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There continues to be much press coverage around the EU Financial Transaction Tax ("EU FTT"). There has been speculation that the draft Directive issued earlier this year will be considerably diluted and that the eleven countries within the Enhanced Cooperation Procedure are struggling to reach consensus. Notably, there was no mention of the EU FTT as part of the Irish Presidency report to the ECOFIN at the end of last week and official commentary has been limited. EU Tax Commissioner Semeta has stated that such news reports do not reflect what is currently going on in the Council. So what is going on in the Council and where do the negotiations stand? In this newsflash we provide an update on what continues to be a highly political topic.

The process: where are we?

Shortly after the Commission presented its draft Directive to the Council on 14 February 2013 under the EU's Enhanced Cooperation Procedure, the national fiscal attachés of the EU-27 Member States started a series of technical discussions in the Council Working Party on Tax Questions - Indirect Taxation (FTT) (the "Working Party") under the Irish EU Presidency. In these discussions the fiscal attachés go through the articles of the draft Directive in order and propose amendments. The attachés can also ask the Commission, present throughout as the proposer of the EU legal act, to clarify the articles and their impact further.

Importantly, in parallel to this EU-27 process the 11 Participating Member States ("ECP-11") in the Enhanced Cooperation Procedure also met several times informally from February to mid-April 2013.

This is the first time the Enhanced Cooperation Procedure has been used in the area of EU taxation policy. It is very much 'learning by doing' for everyone involved in the process. This has led to the unusual situation whereby the ECP-11 are required to reach a compromise on the EU FTT, yet the other non-participating EU-16 also sit at the Council negotiating table despite having no voting powers and no intention of implementing this piece of EU law. One of the non-participating Member States, the UK, is present at the discussions having recently filed a complaint with the EU's courts that the very procedure being used is illegal (please refer to our FS Newsflash on this topic released on 24 April 2013). This makes the EU FTT a very complex political dossier with multiple competing interests.

During the second Working Party held on 16 April 2013, the ECP-11 reportedly disagreed on even very basic points such as what they wanted to achieve with the EU FTT, who they wanted to tax, what the FTT should look like and how it should be implemented and collected. A meeting document leaked to the press revealed that some of the ECP-11 suddenly had significant concerns about the proposal's impact. Yet the ECP-11 countries cannot simply withdraw from the process and must take part in the final vote in the ECOFIN Council. It is worth remembering that the Enhanced Cooperation Procedure requires at least 9 Member States to vote in favour of the final proposal in order for the proposal to pass into law.

It also became clear in April 2013 that the EU's focus had moved on to other dossiers

on which EU-27 political agreement is considered more readily achievable, such as the EU's revised Savings Directive, automatic exchange of information and the EU's reaction to the OECD's BEPS initiative.

Finally, it became apparent by April that France and Germany, who had led the ECP-11 on EU FTT from an early stage, may not be able or willing to continue to drive the initiative. Germany is not interested in making any substantive progress until after the German federal elections scheduled for 22 September 2013 and France's position on the draft EU FTT had become more ambiguous, ultimately leading to a French denouncement of the current proposal at the end of May 2013. This came after the third Working Party on 22 May which apparently saw the ECP-11 increasingly divided amongst the smaller ECP-11 countries on the one hand, in favour of the residence principle, and Germany, France, Italy and Spain on the other hand, in favour of the issuance principle. We also understand the Working Party only got to Article 4 under first reading. A fourth Working Party that was scheduled for 13 June was postponed to the second half of July, under Lithuania's EU Presidency. We note that EU FTT was not included on the agenda of the 21 June ECOFIN Council, nor the EU's Summit of 27/28 June 2013.

Recent press reports confirm what we have been suggesting for some time: the current, broad scope draft Directive is likely to be diluted by the participating countries. EU Tax Commissioner Semeta has responded to the press reports by stating that such news reports do not reflect what is currently going on in the Council. The EU Parliament's ECON Committee adopted Parliament's draft Opinion on the Commission's EU FTT proposal on 18 June and this will be broadly endorsed by the whole Parliament in its Plenary Session in the first week of July. However, this is non-binding advice from MEPs to Council, as required by EU law, and could therefore be seen as a procedural matter rather than a substantive development in the debate.

What do we expect?

Given the need to balance local interests across the ECP-11, it is perhaps not surprising that the negotiations have led to disagreement. Any model for the EU FTT proposed is likely to benefit some Member States over others (for example, a change in the definition of 'establishment' so as to prioritise the issuance principle over the residence principle would likely increase FTT revenues arising to the likes of Germany, France, Italy and Spain, with a fall in revenues for the smaller members of the ECP-11). Ultimately it should be possible to balance these various interests through compromise and amendments to the proposed Directive as the negotiations proceed.

It should not be forgotten that significant political capital has been invested in implementing an EU FTT. For this reason, in our view the Enhanced Cooperation Procedure is likely to survive.

It is important to understand that the ball is now in the camp of the ECP-11. The Commission's proposal will not be adopted in its current form. Yet, from what we're hearing in Brussels, we believe that the Enhanced Cooperation Procedure is likely to lead to an EU FTT being introduced across multiple countries in the EU, and, potentially in as many as 20 or more EU countries depending on its final form.

Turning to the form of the final FTT, in our view we are likely to see a phased approach, starting with a narrower form EU FTT similar to the UK SDRT or French FTT on equities and possibly covering derivatives as well like in the Italian FTT, but this might also be part of a second phase whereby the participating Member States could agree to review the Commission's proposal after 3 or 5 years. So, contrary to the hopes of some in the market, in our view it may be too optimistic to assume that such a narrow scope EU FTT will cover only equities. This is particularly given the likely revenues which would be generated from such a narrow-based tax based on recent experience in

France and Italy – the revenue from a narrow equities tax would fall some way short of the €30-34bn annual target that was identified in the Commission's revised proposed Directive. Key areas for recent debate have included the taxation of sovereign debt (given the already high borrowing costs of some Southern EU Member States involved in the ECP) and the taxation of repo transactions (as highlighted by ICMA, amongst other industry groups, and reinforced by comments from the European Central Bank). Therefore these are two areas in which exemptions would seem likely.

In the meantime, the Commission has acknowledged that the originally proposed date for the EU FTT to come into effect, 1 January 2014, is no longer realistic. According to sources in Brussels, 1 January or 1 July 2015 or even 1 January 2016 may be more realistic. That said, one could expect the process to regain momentum after the German elections in September, and the domestic FTTs in France and Italy could be seen as setting a precedent for introducing a stamp-duty style regime in a very short timeframe.

What can you do?

Given the unpredictability of this topic, it remains important for financial institutions and affected corporates to continue to monitor developments in this area closely.

Many affected institutions and industry groups have worked hard to inform the debate with policy-makers and politicians, highlighting concerns they have with the impact of the proposals in areas including the competitiveness of the FS industry, financial stability, market liquidity and knock-on implications for the non-FS sector and wider economy.

Given that, in our view, the Enhanced Cooperation Procedure will result in an EU FTT across multiple EU Member States, there remains a danger of complacency since there remain a number of issues not yet discussed in detail. For example, one key feature of the proposed regime is the very broad scope of the tax on derivatives – there would appear to be more work to do in balancing the policy objectives of the ECP-11 with the impact on the real economy of subjecting all derivatives to the tax.

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