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FTT newsletter

A round-up of FTT developments across Europe

Following the publication of the revised draft of the FTT directive, and in light of the questions which we have been receiving in terms of what transactions do and do not fall within the scope of the FTT as drafted, we thought it may be helpful to illustrate the application of the draft directive through some examples as set out below.

To discuss any aspect of FTT please contact your usual Deloitte contact or **Martin Walker** on +44 20 7303 7644.

EU FTT

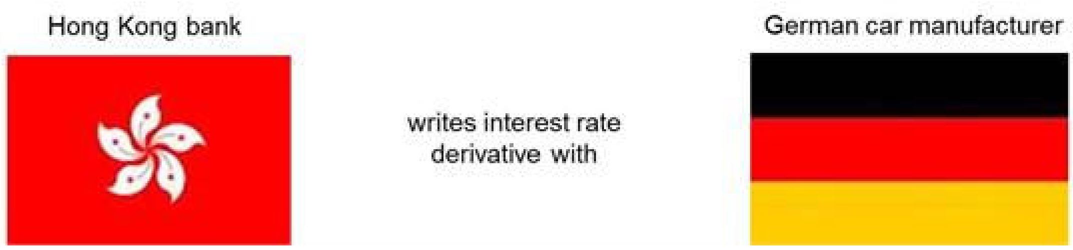
The following examples illustrate the potential application of the EU FTT to different transactions. All rates referred to are minimum amounts.

Example 1

A Hong Kong bank, which writes an interest rate derivative (e.g. fixed: floating) with a German car manufacturer in order to hedge the manufacturers currency exposure in selling cars abroad. The interest rate derivative is a "financial institution" for EU FTT purposes.

The Hong Kong bank is deemed to be established in Germany for EU FTT purposes on the basis that its counterparty is established in Germany. The bank is liable to pay 0.01% of the notional value of the interest rate derivative.

This derivative would give rise to FTT no matter who the German car manufacturer buys the interest rate protection from, whether a German bank, a UK bank or an Asian bank. On the other hand, if the Hong Kong bank writes an interest rate derivative with an Indian car manufacturer, no such FTT liability would arise. It is worth noting that further FTT charges may arise if the bank hedges its position under the derivative with a party in the FTT zone.



Example 2

A Swiss bank which enters into a trade over Spanish government bonds with a Swiss customer is entering into a financial transaction for EU FTT purposes. The Swiss bank is deemed to be established in Spain on the basis that it is a party to a financial transaction in a financial instrument issued in Spain. The bank is liable to pay 0.1% FTT of the price paid for the bonds. If the customer is also a financial institution, it is also deemed a resident of Spain on the same grounds and also liable to 0.1%. It is worth noting that if the Swiss bank purchases the bonds in a principal capacity so as to fulfil its customer's order, there would also be a 0.1% charge on that purchase (and quite likely a 0.1% charge for the seller), and so on. In this way, although the FTT headline rates are relatively low, the cascading effect results in a far higher headline rate.

Example 3

This currency derivative, written by the London branch of a Canadian bank, to hedge foreign exchange (FX) fluctuations is a financial transaction for EU FTT purposes. While FX spot exchanges (broadly akin to changing money at a bureau d'echange) are exempt from FTT, currency futures, options and other FX derivatives are within scope. Although neither Canada nor London are within the FTT zone, the fact that the purchaser of the currency hedge is in France means that the Canadian bank is deemed to be established in France for EU FTT purposes. The bank is liable to pay 0.01% of the notional value of the interest rate derivative, together with any FTT arising on an equal and opposite derivative to hedge its position created under the customer trade.

Example 4

There is no link to an FTT zone country where a UK broker sells Dutch shares to a US pension fund, so no FTT applies. Of course, the answer would be different if the Netherlands were to join the FTT zone if the shares were issued by an FTT zone country, which could (assuming some or all of the cost of the FTT is passed on to the end investor) incentivise the pension fund to invest in non-FTT zone countries. If the UK broker were to sell the same shares to an Italian pension fund, then FTT would arise, which could (again assuming that some or all of the cost of the FTT is passed on to the end investor) potentially lead to pension funds set up in the FTT zone suffer higher trading costs by comparison to funds established outside the zone. It is worth noting that some countries, both inside and outside the FTT zone, are thought to favour an exemption for pension funds.

Example 5

A loan of securities is specifically included within the definition of financial transaction. Recital (5) to the draft, however, directly stipulates that a securities lending arrangement gives rise to one transaction only, namely putting a financial instrument at the disposal of another person for a specified period of time. As the securities loaned are issued in Belgium, an FTT zone country, the Canadian pension fund and the agent lender are both deemed to be established in Belgium. That would mean that the pension fund (as a defined financial institution) is liable to FTT at 0.1% in total on the outward loan and return combined, which would impact the fees available to the pension fund through lending programmes. Where the agent lender, acting in an agency capacity, is acting in the name of another financial institution as borrower, only the borrowing financial institution acting as principle is liable for 0.1% on both the borrow and return combined. Of course, further FTT charges could arise if the borrower sells short the shares or on-lends them.

LATEST NEWS

The draft decree clarifying certain details of the application of the **Italian FTT** remains to be finalised by the Italian Ministry of Economy and Finance.

The **Dutch government** has withdrawn its support for the EU FTT. This is understood to be because the revised draft of the FTT directive does not include any exemption for pension funds or pensions pooling vehicles. It if course possible that the Netherlands could in the future support the FTT in the event the draft directive were amended to include an exemption for pensions funds.

The **Portuguese government** has confirmed its intention to await the approval of the draft FTT directive through the enhanced co-operation process, in which it is participating, rather than implementing a unilateral FTT in Portugal.

In the **US,** senators are attempting to reintroduce a Wall Street trading and speculators tax of 0.03% on secondary trading of financial instruments, aimed at proprietary and high frequency trading activities. Commentators believe that such a proposal may be unlikely to progress through Congress, although it cannot be ruled out given the popularity of FTT proposals in the current environment. This proposal also sits uneasily with the reported opposition from the US Treasury and certain US industry bodies to the EU FTT as currently drafted.

A list of Deloitte's FTT contacts across Europe can be found **here** along with a link to the **FTT website**.

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