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FTT newsletter

A round-up of FTT developments across Europe

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Following the approval last week of the enhanced co-operation procedure ("ECP") for 11 member states to take forward the EU FTT, this week saw much discussion on the potential shape and reach of the European Commission's revised draft of the FTT directive which is expected to be released in the next two weeks. Our newsletter considers some of these key discussion points below.

In addition, the Italian Ministerial Decree on Italian FTT was published for consultation (further details of which will be included in next week's newsletter).

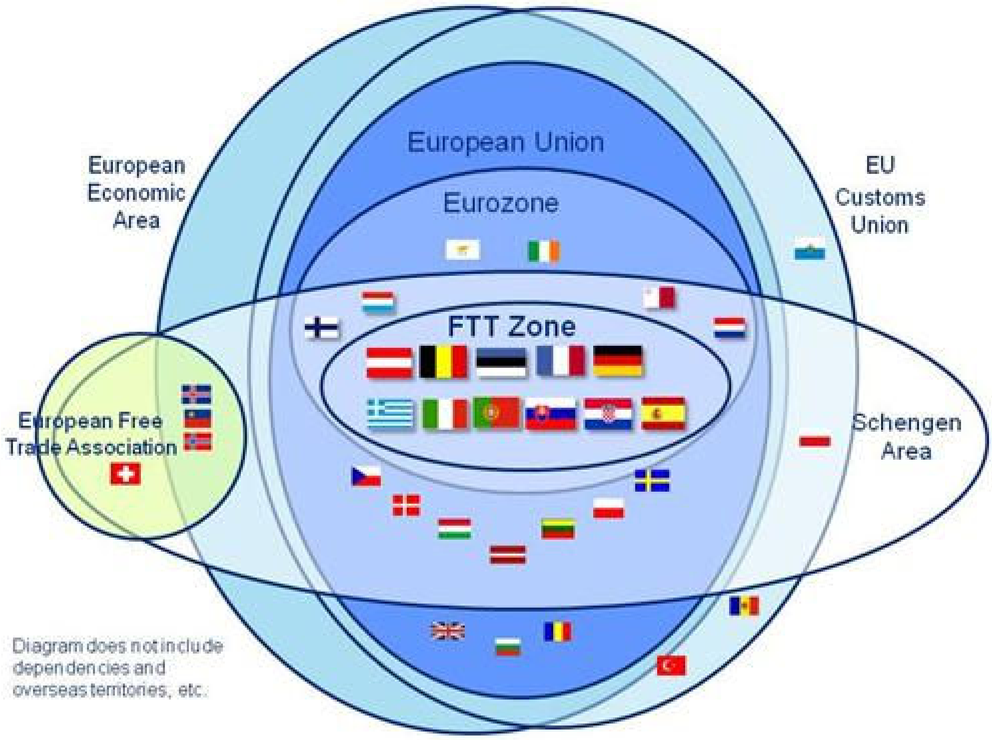
To discuss any aspect of FTT please contact your usual Deloitte contact or **Martin Walker** on +44 20 7303 7644.

The EU FTT

It is expected that the revised draft of the EU FTT proposal will be published by the Commission in mid-February. There has been much discussion on how the key aspects of the revised draft will operate. This week's newsletter considers some of the key issues to be resolved as the Commission and the 11 member states in the FTT zone develop the proposed design and implementation of the EU FTT.

ECP Vote

The diagram below shows that Europe already operates on a multi-tiered basis. It illustrates why we should not be surprised by those countries which are participating in the ECP and those which are not, quite apart from the risks and rewards of the EU FTT proposal itself. EU FTT introduces a new grouping. The 11 participating countries (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain) are within the very centre of existing European frameworks and initiatives, notably both the Euro currency union and the Schengen borderless zone. This clearly illustrates just how central politics is to the EU FTT and the FTT zone comprises an ever-smaller group of countries at the heart of Europe. While all member states can be involved in discussions about the design of the EU FTT, it is only those participating member states in the FTT zone who will have the opportunity to vote on it.



The member states which abstained from the ECP vote (Czech Republic, Luxembourg, Malta and the UK) are either outside one or both of these zones or are seeking to protect domestic funds industries.

Financial instruments in scope

The Commission has stated there are likely to be no major differences between the revised proposal to be released in mid-February and the original September 2011 proposal. If, as widely expected, this is correct, this means that the draft of the EU FTT to be discussed between ECP participating countries will cover shares, bonds and derivatives, as well as other financial instruments such as units in UCITs funds. Neither France nor Italy, which have introduced their own national FTTs, have sought to tax financial instruments other than equity (or similar) securities and, in the case of Italy, derivatives over equity (and similar) securities. The EU FTT would therefore be significantly broader than the current FTTs in place and affect a wider range of market participants. Including a broad range of derivatives would expand the impact beyond the financial industry; other industries which rely upon derivatives to hedge risk, such as manufacturing, oil and gas, would then also be affected.

It is widely anticipated that, under the revised draft, the EU FTT would apply on both an issuer and residence basis. This means that EU FTT would apply when dealing with a resident of an FTT zone country or when dealing in securities issued in an FTT zone country. This contrasts with the issuer bases adopted in France and Italy, where only securities issued in those countries are subject to the tax.

(Extra-)Territoriality

Financial institutions outside the FTT zone, whether in London, Hong Kong, New York or Zurich, would not therefore escape the FTT owing to an expansive definition of "resident" of an FTT zone country. In order to counter concerns that the EU FTT might encourage dealings in financial transactions outside the FTT zone, the EU FTT has almost unprecedented extra-territorial reach. The original draft of the EU FTT applied the tax if a financial institution (drafted broadly) is a party to a financial transaction and either the financial institution or its counterparty is a resident of a country which has implemented the EU FTT. If implemented in this form, this would mean that were a bank in Asia to write an FX derivative with a German car manufacturer, the Asian bank would be liable to pay FTT to Germany. Likewise, a London branch of a bank with its headquarters in say France would also be within the scope in respect of every financial instrument it deals in. Where both financial institutions are linked to the FTT zone then each is liable for the FTT, so a double charge arises.

It is also anticipated that the design of the EU FTT will be extended to cover dealings in securities issued in an FTT zone country (or even securities such as American Depositary Receipts over underlying FTT zone securities), no matter who or where the parties are or where that security is traded. Knowing the full identity and status of trading counterparties and the place of issue of securities would therefore be paramount in order to comply with the EU FTT.

The issue of double taxation does not seem to have been thought through fully and may not be adequately covered by existing double tax treaties. For example, if a UK share is purchased by an investor in the FTT zone, this would seem to be subject to both UK stamp duty reserve tax (SDRT) and the EU FTT. While countries in the FTT zone are likely to be obliged to abolish any other transaction taxes which overlap with FTT, there is clearly the risk of double taxation where non-FTT zone countries impose a similar tax.

Finally, it will be interesting to see whether other countries (such as China or India) whose financial institutions come within the scope of the EU FTT when dealing with FTT zone residents or securities might consider imposing their own FTTs when FTT zone countries deal with one of the residents of, or deal in securities issued in, that country.

It remains to be seen how the EU FTT will be collected and enforced, especially outside the EU.

Exemptions

Primary market transactions, such as new issues of shares and bonds are not subject to EU FTT. Nor are transactions with the European Central Bank, central banks of EU member states and certain European and international bodies, as well as certain restructurings. No exemption for pension funds is currently included, but this could be something which participating member states may wish to negotiate on and is known to be a concern of countries such as the Netherlands, which is not currently in the FTT zone.

It remains to be determined to what extent, if any, a market maker exemption, such as the intermediary exemption in the UK or the market maker exemptions in France and Italy, would be available. Without such an exemption, the EU FTT charges on seemingly simple transactions could be multiplied, increasing the effective EU FTT rate. The potential for multiple charges on the same economic transaction owing to the way in which markets are structured raises cause for concern. For example, a typical simple broker to broker trade can involve securities being transferred by a broker to a clearing member of a settlement system to a central counterparty (this leg is exempt) to a clearing member of the settlement system to the buying broker, which under the original draft of the EU FTT could impose six charges to FTT as each transaction is chargeable at a minimum 0.1% on both the buyer and the seller if either is in the FTT zone. There could be further charges if collateral is posted to reduce risk in relation to such trades.

The original proposal also applied to stock lending and sale and repurchase (repo) trades, as well as other forms of collateral. Such transactions may be considered for an exemption or a reduced rate, but asset managers, banks, insurers and pension funds who routinely lend out securities to raise revenues could be adversely impacted if no exemption is available. A general exemption for the provision of securities to collateralise counterparty risk would be a laudable development, as otherwise the EU FTT could unwittingly encourage uncollateralised risk taking by financial institutions.

Timing

The Commission is understood to continue to push for a commencement date of 1 January 2014, although it is hard to see how this can be achieved in practice. Several key points of the design of the EU FTT (as outlined above) remain to be finalised. In addition, the 11 FTT zone countries have financial markets of differing size and importance economically and politically, and motivations for the tax may differ from one country to another: whether to introduce an FTT as swiftly as possible to raise much needed revenues, or to introduce a broad-ranging FTT to satisfy more political goals. It may be that in order to introduce an EU FTT in the near term, the first phase could cover only equities and equity derivatives (plus perhaps high frequency trading), with further financial instruments to come within scope at a later date.

It should be noted that the EU FTT will be implemented as a directive, which means (broadly) that each participating member state must transpose into its own national law the provisions of the directive. Even once the EU FTT is agreed between the governments of the 11 member states, legislation still needs to be passed in each FTT zone country.

It is understood that Germany is not expecting to raise EU FTT revenues until at least 2016. Although it is likely to push for agreement on the broader EU FTT before then, this is perhaps a more realistic assessment of the likely timeframe.

UNILATERAL FTTs

The Ministerial Decree clarifying certain aspects of the Italian FTT has been released for publication and further details will be included in next week’s newsletter.

AND FINALLY

Deloitte has launched a new **FTT website** which is freely available for clients to view. Thank you to our Luxembourg colleagues who are currently hosting the site. All previous copies of the FTT Newsletter are available to view, and the site will be updated in due course to include forthcoming Deloitte events and FTT developments. If you have any comments or feedback on the website, we would be glad to receive them.

A list of Deloitte’s **FTT contacts** across Europe can be found here.

Martin

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