EU Tax Centre

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European Commission issues proposal for a Financial Transactions Tax

On September 28, 2011, the European Commission published a draft directive that would introduce an EU wide financial transaction tax (FTT).

Background and objectives

In the context of discussions as to the role of the financial sector in the recent financial crisis, questions were raised on potential approaches to ensuring, on the one hand, that the sector contributes to the costs of the crisis, and, on the other hand, that measures are taken to avoid a future crisis (e.g. by discouraging high-risk financial transactions that could destabilize the sector). In addition to regulatory measures being introduced at EU level, introducing a specific tax on financial sector transactions was seen as a potential solution to the above. The FTT is also seen as a potential source of revenue, that could partly replace existing Member State contributions to the EU budget.

The European Commission has now issued a draft directive that would introduce the FTT in the EU. According to the Commission, current indications are that the directive is likely to generate revenues of around 57 billion euros annually at EU level.

Scope

The FTT has been designed to cover a wide range of financial transactions, including the purchase and sale of financial instruments (e.g. securities, money-market instruments, units/shares in collective investment undertakings, notes and structured products), the transfer of the risk associated to a financial instrument between members of a group (even if not part of a purchase/sale) and also the conclusion of derivatives agreements such as options, futures, swaps and forward rate agreements relating to securities or commodities. According to the draft, the FTT is aimed at taxing transactions involving financial institutions and not ordinary transactions carried out by ordinary individuals or businesses (e.g. conclusion of insurance contracts, mortgage/consumer credits, spot foreign exchange agreements, primary market operations), hence such operations are excluded from the scope of the directive. However, the subsequent trading of these transactions via structured products is subject to the FTT as well as the subscription and redemption of shares and units of UCITS and alternative investment funds such as private equity funds.

Financial institutions are broadly defined under the draft directive to include traditional financial institutions (e.g. investment entities, organized markets, credit institutions, insurance and reinsurance undertakings, collective investment undertakings and management companies thereof, alternative investment funds and legal persons managing such funds, pension funds and fund managers thereof, financial leasing companies), but also holding companies, special purpose vehicles (such as securitization entities and entities which assume the risk of (re)insurance undertakings) and any other persons that carry out certain significant financial operations by reference to volume or value. Financial institutions are subject to the FTT even if they act in the name or for the account of another person.

In order for the Directive to apply, at least one of the parties to the transaction needs to be established in a Member State. This is a broad concept covering regulatory authorization, registered address, branches etc. Where more than one financial institution is party to a transaction each will be liable to the tax. It appears that this is the case irrespective of whether they are established in the same or different Member States. Financial institutions established outside the EU may also become subject to the FTT if one of the parties to the transaction is established in the EU, unless it can be proven that there is no link between the economic substance of the transaction and the territory of any Member State.

Chargeability, amounts and rates

FTT becomes chargeable when the financial transaction effectively takes place and aims at taxing gross transactions before any netting off. The taxable amount depends on the type of the financial transaction. Generally, in case of a financial transaction other than a derivatives transaction, the taxable amount is in effect the value of consideration paid as part of the financial transaction. However, in certain circumstances the at arm's length market price of a transaction will be used in stead of the price agreed upon between the parties to the transaction.
In the case of transactions involving derivatives, the taxable amount is the notional amount.

The Directive provides for a minimum required level of FTT of 0.1% for financial transactions other than those related to derivatives agreements and 0.01% in the case of derivative agreements.

Member States are required to implement the necessary framework to ensure that the FTT is declared and paid according to the Directive. FTT is payable at the moment when electronic transactions take place and within three working days in other cases. Liable persons are required to submit a monthly FTT return by the tenth day of the following month.

Member States are also required to lay down registration, accounting, reporting and other obligations intended to ensure effective payment of the FTT. In addition, they are required to adopt measures to prevent tax evasion, avoidance and abuse. They may not maintain or introduce taxes on financial transactions other than the FTT or VAT.

Legislative process

The next step in the legislative process is for the proposal to be discussed within the EU Council. A unanimous decision of the Council (in accordance with a special legislative procedure and after consulting the European Parliament), is required in order for this proposal to be introduced. This might well result in the text suffering significant changes before adoption. More information can also be found on the *Commission's Website*.

According to the draft text, the implementation deadline for Member States is December 31, 2013, with the provisions becoming effective starting January 1, 2014.

EU Tax Centre Comment

Despite the deadline indicated by the directive, the timeline for its implementation is yet unknown, as it requires unanimity at Council level. There is currently no official indication on the position of the various Member States, but it seems likely that there is a degree of support from a number of Member States. However, we anticipate strong opposition from certain Member States, in particular in view of the concerns that financial transactions may be relocated outside the EU to avoid application of the FTT. In the media the UK has been mentioned as a strong opponent.

Should you require further assistance in this matter, please contact the EU Tax Centre or, as appropriate, your local KPMG tax adviser.

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