EU Financial Transaction Tax

On 14 February 2013 the European Commission published a proposal for an EU directive concerning the implementation of the EU financial transaction tax (the FTT).

The countries currently participating in the implementation of the FTT are: Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain (each a Participating Member State).

Next steps for implementation and timetable

It is understood that formal discussions at an EU-wide level will continue over the next few months with a view to finalizing the proposed directive as early as summer 2013. Following that, the directive would be implemented into domestic legislation in the Participating Member States (currently proposed to occur on 30 September 2013), with the FTT becoming fully effective thereafter (currently proposed to occur on 1 January 2014).

Given the strength of political will behind the proposed FTT, we consider it likely that the FTT will be introduced in some form. However, in view of the deficiencies in the current text of the proposed directive and the push by certain Participating Member States to modify the text (including introducing further exemptions), it would not be a surprise if the anticipated timetable slips towards the middle or end of 2014. If the introduction of the FTT is delayed, it will still be important to give consideration to the numerous domestic FTT equivalents (see below for further detail) which are, or are accepted to be, in effect prior to the FTT coming into force.

Scope of the FTT

The scope and coverage of the proposed FTT is intended to be wide. It is focused on “financial transactions” carried out by “financial institutions”.

Financial transaction

The concept of a “financial transaction” covers:

- the sale and purchase of a “financial instrument” before netting or settlement;
- an intra-group transfer of the right to dispose of or the risks associated with a “financial instrument”;
- the conclusion of a “derivatives contract” before netting or settlement;
- the exchange of a “financial instrument”; and
- repos, reverse repos, securities lending and borrowing agreements.

The definition of a “financial instrument” is also drawn widely and is proposed to encompass instruments which are negotiable on the capital markets, money-market instruments, units or shares in UCITS and AIFs and derivatives contracts.
The scope of the FTT is not limited to trade in organized markets, such as regulated markets, multilateral trading activities or systematic internalizes, but also covers other types of trades including over-the-counter trades.

In practice, this will mean that most equities, debt securities and derivatives would fall within the scope of the FTT. However, certain transactions are explicitly excluded from the scope of the FTT, including the making of loans and the issuance of shares and units in collective investment schemes.

**Financial institution**

The definition of “financial institution” is very broad, and may apply to companies and other undertakings that would not otherwise expect to be caught.

A “financial institution” will include: (i) investment firms, organized markets, credit institutions, insurance and reinsurance undertakings, collective investment undertakings and their managers, pension funds and their managers, holding companies, financial leasing companies and special purposes vehicles; and (ii) other vehicles and arrangements which carry out one or more specified activities of a financial nature and where the value of the “financial transactions” carried out by such a vehicle or arrangement constitutes more than 50% of its overall average net annual turnover.

The activities which are specified for this purpose will include: (i) accepting deposits and other repayable funds; (ii) lending, including consumer credit, factoring and financing commercial transactions; (iii) financial leasing; (iv) providing guarantees and commitments; (v) trading (either on own account or on behalf of customers) in “financial instruments”; (vi) acquiring holdings in undertakings; (vii) participating in or issuing “financial instruments”; and (viii) providing services related to any activities referred to in (vii).

The only specific exclusions from the definition of “financial institutions” are for Member States, the European Central Bank, the European Financial Stability Fund, the European Stability Mechanism, the European Union (to the extent it exercises the function of management of its assets and other activities) and central banks of Member States (but any counterparty to a transaction with any of the aforementioned may still be liable to the FTT).

It is important to note that, as currently drafted, the proposed directive does not provide for any form of intermediary exemption or any intra-group exemption. Accordingly, brokers, market-makers and other financial intermediates will all potentially be subject to the FTT.

**Territorial scope of the FTT**

The FTT will have a very wide extra-territorial effect, and will apply in circumstances where companies would not otherwise expect a liability to arise.

This is due to the fact that a relevant financial institution will become subject to the FTT if it is “deemed to be established” in a Participating Member State. A financial institution will be “deemed to be established” in a Participating Member State if:

1) it is authorized by the authority of that Participating Member State to act as a financial institution, in respect of transactions covered by that authorization; or

2) it is authorized or otherwise entitled to operate, from abroad, as a financial institution in the territory of that Participating Member State, in respect of transactions covered by such authorization or entitlement; or

3) it has its registered seat in that Participating Member State; or

4) its permanent address or, if no permanent address can be ascertained, its usual place of residence is located in that Participating Member State; or

5) it has a branch in that Participating Member State in respect of transactions carried out by that branch; or

6) it enters into a financial transaction with another financial institution which is established in that Participating Member State (within 1 to 5 above); or
it is a party to a financial transaction in a financial instrument (excluding, in broad terms, derivatives which are not 
traded on an organized platform) where such an instrument has been issued from within the territory of that 
Participating Member State.

A financial institution is required to pay the FTT to the Participating Member State in which it is deemed to be 
established for the purposes of the relevant financial transaction. In circumstances where a financial institution satisfies 
more than one of the conditions set out in 1 to 7 above, the first condition fulfilled from the start of the list in 
descending order shall be relevant for determining in which Participating Member State such a financial institution is 
established.

There is an exception under which a financial institution can be deemed not to be established in a Participating 
Member State if it can prove that there is no link between the economic substance of the relevant financial transaction 
and the territory of any Participating Member State (but this will be difficult to show in most cases).

**Payment of the FTT**

The proposed rates of FTT under the proposed directive are: (i) for transactions other than transactions in derivatives, 
a minimum rate of 0.1% of the consideration; and (ii) with respect to transactions in derivatives, a minimum rate of 
0.01% of the “notional amount” referred to in the derivatives contract at the time of the transaction.

It is important to note that the FTT will be levied upon both a seller and a purchaser in any relevant financial 
transaction. Further, in circumstances where a financial instrument is transferred along a chain of purchasers and 
sellers, each separate element, or transaction, in that chain would potentially attract FTT.

In terms of determining who is liable to pay the FTT, it is important to note that the directive imposes joint and several 
liability on the parties to the relevant transaction for any FTT due (and also gives the Participating Member States the 
power to extend such joint and several liability to other persons).

**Domestic FTT equivalents**

France and Italy have both already introduced their own limited forms of domestic transaction tax on certain financial 
transactions, and Portugal and Spain are in the process of introducing similar domestic regimes.

Although broadly similar in approach and ambition, it is understood that each of these domestic transaction taxes is 
likely to have a different scope, rates and technical design. It is assumed that, once the FTT regime has come into 
effect, the different domestic regimes will have to be modified to bring them into line with the wider FTT regime.

The United Kingdom already operates a far more restricted regime which, in practice, generally only applies to the 
transfer of shares issued by UK companies and shares held on a UK register.

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