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Accompanying the document

Proposal for a COUNCIL DIRECTIVE

implementing enhanced cooperation in the area of financial transaction tax
Analysis of policy options and impacts

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Implementing enhanced cooperation in the area of financial transaction tax
Analysis of policy options and impacts

This document is a response to the request by both participating and non-participating Member States for an analysis of the impacts and economic consequences associated with the introduction of a financial transaction tax by way of enhanced cooperation. It also tries to identify and analyse options that help to minimize evasive actions, distortions and transfer of financial services to other jurisdictions, and it analyses the impacts of some of the options discussed in the Council's Working Party on "Tax Questions" under the Danish Presidency in the first half of 2012. This document does not constitute in itself an Impact Assessment and it should be read in conjunction with the Impact Assessment having accompanied the initial proposal and additional analysis undertaken and made public by the European Commission since, as it builds on the findings of these analyses and makes use of them. This document commits only the Commission's services involved in its preparation.

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1. INTRODUCTION

On 28 September 2011, the Commission adopted a proposal[1] for a Council Directive on a common system of financial transaction tax (FTT) and amending Directive 2008/7/EC[2].

The legal basis for the proposed Council Directive was Article 113 TFEU, as the Commission proposed provisions for the harmonisation of legislation concerning the taxation of financial transactions to the extent necessary to ensure the proper functioning of the internal market for transactions in financial instruments and to avoid distortion of competition. This legal basis prescribes Council unanimity in accordance with a special legislative procedure, after having consulted the European Parliament and the Economic and Social Committee.

While already before the onset of the financial and economic crisis some Member States had narrowly-based taxes on some financial transactions in place[3], several others have decided or committed themselves to either introduce such a tax, broaden its scope and/or increase the tax rates so as to ensure that financial institutions make a fair and substantial contribution to covering the costs of the recent crisis, and for consolidating public budgets.

In this context the efficient functioning of the internal market (for financial services and beyond) required action intended to avoid distortion of competition across borders, and among products and actors. Also, considerations as regards tax neutrality required harmonisation with a broad scope, notably to also cover very mobile products such as derivatives, mobile actors, and market places.

The Commission's proposal for a Directive on a common system of FTT set out the essential features of such a common system for a broad based FTT in the EU that aims at achieving these objectives. It was conceived so as to minimise the risk of relocation, notably by foreseeing very low tax rates, taxing both ends of the transaction, and foreseeing a taxation of all financial transactions in financial instruments (all markets, all actors, all products) in which at least one party to the transaction is established in a Member State and where a financial institution established in the territory of a Member State is party to the transaction, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction. Thus, the tax could only be avoided by those financial institutions that no longer wanted to serve the EU market.

However, despite these powerful anti-relocation measures foreseen, already during the first relevant meeting of the Council on Economic and Financial Affairs of 8 November 2011, some Member States declared that they were against any common system of financial

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[1] COM(2011) 594 of 28 September 2011.

[2] Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital, OJ L 46, 21.2.2008, p. 11–22.

[3] At present, there are ten Member States that have a form of FTT in place in the EU 27, out of which three are situated in the EU11. Three others from the EU 11 have planned to introduce one as of next year. See Annex 1 for more details.

transaction tax at the level of the European Union unless an FTT of similar kind was introduced at the global level.[4]

During the seven meetings of the Council's "Working Party on Tax Questions – Indirect Tax (FTT)" (hereafter "Council Working Party"), first under the Polish and then under the Danish Presidency, in which also numerous alternative design features of an FTT based on the Commission proposal were tabled, examined and discussed, it was confirmed that unanimous support for a common system of FTT, be it along the lines of the Commission proposal or any variant thereof, could not be reached at the level of all Member States.

At the Council meeting on 22 June 2012, the Member States that had expressed their opposition to a common system of FTT already at earlier stages reiterated their position. In those circumstances, several other Member States voiced their intention to request an authorisation for engaging in enhanced cooperation in accordance with Article 20 TEU and Article 329 TFEU. Some of the opponents to a common system of FTT (of any kind) stated that they would not oppose a procedure of enhanced cooperation on this issue in case all the necessary requirements were met.

Having regard to the views expressed, the (Danish) Presidency concluded at the same meeting that support for an FTT as proposed by the Commission was not unanimous. The Presidency also noted that there was support by a significant number of delegations for considering enhanced cooperation.

At the Council meeting of 10 July 2012, the (then Cypriot) Presidency referred to the discussions held at the Council meeting of 22 June 2012. It noted the lack of unanimous support for the FTT proposal discussed under the Danish Presidency. It concluded that essential differences in opinion persist as regards the need to establish a common system of FTT at EU level and that the principle of harmonised tax on financial transactions will not receive unanimous support within the Council in the foreseeable future. It finally noted that there is support by a substantial number of Member States for considering enhanced cooperation, which would allow a limited number of Member States to first proceed among themselves.

In these circumstances, eleven Member States (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, Spain) have addressed formal requests to the Commission indicating that they wish to establish enhanced cooperation between themselves in the area of the establishment of a common system of FTT and that the Commission should submit a proposal to the Council to that end.

On 23 October 2012, the Commission presented its findings on these requests. It could not find a single incidence of non-compliance of these requests with Treaty provisions and, after assessing the political opportunity of progress on this file, proposed a Council Decision authorising enhanced cooperation in the area of financial transaction tax.[5]

The present document summarises the findings of the analysis undertaken by the Commission notably in the context of facilitating the discussions in the Council Working Party under the

[4] See section 3.1 for more details on this.

[5] COM(2012) 631 of 23 October 2012.

Danish Presidency in 2012 and in the context of preparing the ground for the concrete design features of a Council Directive implementing enhanced cooperation in the area of financial transaction tax.

2. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

This analysis of policy options and impacts of implementing enhanced cooperation in the area of financial transaction tax benefited and builds on the Impact Assessment having accompanied the initial Commission proposal[6], the annexes to that Impact assessment as well as additional analysis undertaken and published by the European Commission[7].

The present document also benefited from the consultation of various interested parties over the last year, such as Member States, the European and national parliaments, representatives of the financial industry from within and from outside the European Union, the academic world, workers' and employers' associations, non-governmental organisations, and the results of ad hoc external studies and position papers that had been published in the aftermath of the tabling of the Commission's initial proposal on a common system of FTT for the entire European Union.[8]

Commission representatives participated in numerous public events across and outside Europe on the establishment of a common system of financial transaction tax. Also, the Commission actively participated in a dialogue with various national parliaments and their relevant committees that indicated interest in discussing the impacts and different policy options for taxing the financial sector.

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[6] SEC(2011)1102 final.

[7] See e.g. the FTT-dedicated website of the European Commission http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/index_en.htm or ECFIN(2012) – Securities Transaction Taxes: Macroeconomic Implications in a General-Equilibrium Model (economic paper by Rafal Raciborski, Julia Lendvai, Lukas Vogel) at http://ec.europa.eu/economy_finance/publications/economic_paper/2012/ecp450_en.htm .

[8] OXERA (2011) – What would be the economic impact on the EU of the proposed financial transaction tax? Review of the European Commission's impact assessment, OXERA (2012) – What would be the economic impact on the EU of the proposed financial transaction tax? Review of the European Commission's latest commentary, Michiel Bijlsma et al./ Centraal Planbureau (CPB) (2012) – An evaluation of the financial transaction tax, Stephany Griffith-Jones and Avinash Persaud (2012) – Financial transaction taxes, Michael Wanger et al./Oliver Wyman (2012) – Proposed EU Commission financial transaction tax impact analysis on foreign exchange markets, John FitzGerald et al./Central Bank of Ireland and the Economic and Social Research Institute (ESRI) (2012) – The EU Financial Transactions Tax Proposal: A Preliminary Evaluation Dorothea Schäfer/ Deutsches Institut für Wirtschaftsforschung (DIW) (2012) – Financial Transaction Tax Contributes to More Sustainability in Financial Markets, Dorothea Schäfer and Marlene Karl/DIW (2012) – Kurzgutachten – Finanztransaktionssteuer, Alternative Investment Management Association (AIMA) (2012) – Financial transaction tax. An assessment of the European Commission's proposed financial transaction Tax, Oskar Henkow (2012) – The Commission's proposal for a common system of financial transaction tax: A legal appraisal, Anita Millar/ International Regulatory Strategy Group (IRSG) (2012) – A financial transactions tax: Review of impact assessments, Swedish National Debt Office (2011) – European Commission proposal for a directive on a common system of taxation on financial transactions.

This consultation complemented the consultation already carried out in the run-up to its initial proposal of September 2011, the conduct and results of which had been documented in the impact assessment document accompanying this initial proposal.[9]

Not surprisingly, the positions of stakeholders differed according to their affectedness by the tax proposed: representatives of the envisaged tax payers such as banks, alternative investment funds and other financial institutions were largely opposed to such a common system (and an FTT in general), while representatives of NGOs and trade unions expressed their preference in favour of such a common system (and the FTT in general).

The seven meetings of the Council Working Party organised under the Polish and under the Danish Presidency in December 2011 and between January and June 2012 have also helped the analysis and the debate on financial sector taxation to a great extent.

The analysis of policy options and impacts was presented to IAB on 27 November 2012. The IAB accepted the document subject to the revision suggested by the board. The IAB suggested firstly that the report should better indicate what changes have taken place since the completion of the original Impact Assessment in financial markets and relevant national tax regimes in order to strengthen the baseline scenario. In response, two Annexes describing the current national tax regimes in the EU and abroad, together with the interpretation of the results as well as additional explanation in section 5 were added. Secondly, the IAB noted that the report should give a clearer overview of the expected aggregate impacts of the discussed options, especially with regard to fiscal stability and private pension funds, and it should provide more clarity about the sensitivity of the results for the assumptions made regarding the recycling of revenues. To implement this suggestion, additional explanation was added in sections 6 and 7. Thirdly, the report should better motivate the qualitative assessments made in the comparison of options and include Annexes that adequately summarise the main quantitative outcomes of the original Impact Assessment. To implement the suggestions, additional explanations and additions covering these aspects have been made throughout the document and especially in Section 6.7. References to the original impact assessment quantitative results are directly made in the report in sections 6.1 and 6.5.

[9] SEC(2011)1102/2 of 28 September 2011.

3. PROBLEM DEFINITION AND SUBSIDIARITY

3.1 Problem definition

Initiatives for taxing the financial sector were brought back into the public debate as of 2008, when the threatening collapse of the global financial system had triggered massive financial interventions by governments around the globe in favour of the financial sector. The costs of the crisis in Europe alone are estimated to be in excess of 15 to 20% of the GDP of EU27.[10]

The economic development since and the relative successful stabilisation of financial markets do not imply a change of the characteristics of the problems to be tackled, namely huge cost to rescue the financial sector pre-financed by the tax payer, the ever more pressing need for bringing public finances back on a sustainable path and the absence of a fair and substantial contribution from the financial sector.

The aim of these initiatives had been and still is to receive a fair and substantial contribution from the financial sector to the financing of the rescue operations from which it benefited either directly or indirectly. In the aftermath of the almost meltdown of the global financial system public debt in Europe soared by more than 20 percentage points and has reached unsustainably high levels which have to be reduced as a priority. In the absence of receiving a substantial and fair contribution from the financial sector itself, Member States are forced to raise taxes somewhere else in the economy and/or to cut public spending and the provision of public goods.

Further aims voiced in that context were also to discourage transactions that do not enhance the efficiency and stability of financial markets as well as high-risk transactions with the help of such a tax, through this complementing and reinforcing the effects of recent and forthcoming regulatory changes aiming at the same objectives.[11] Also, redistributive "internalisation" in favour of the financial sector itself and occurring at the expense of its non-financial clients would have been rolled back to a certain extent.[12]

Finally, other ideas on how the revenues collected could be used for were voiced (such as financing development or climate policy), including to replenish or strengthen bank resolution funds so that in a future crisis it would not have to once again be the tax payer who had to step in for rescuing the financial sector. Taxes to be used for such purposes were taxes on some financial transactions only, notably securities (STT), taxes on financial activity (FAT) and different forms of bank levies and levies on bonuses.

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[10] SEC(2011)1102 final.

[11] See http://ec.europa.eu/internal_market/finances/policy/map_reform_en.htm for more details on the regulatory reform efforts lead by the Commission.

[12] See sections 6.1 to 6.3 for a more comprehensive discussion of these issues.

It was clear from the beginning of the discussions, that taxing financial transactions could only be meaningful if internationally coordinated in case one wanted to minimize tax induced relocation of activity and at the same time generate sufficient revenues. Given the high global mobility of financial services, taxing also very mobile financial transactions, thus going for a broad-based financial transaction tax (FTT) had always been seen as an option that should preferably be implemented and enforced in the context of a globally co-ordinated taxation policy so as to avoid the risk of tax-induced relocation of financial activities and services.

As this first-best solution was not considered likely to materialise in the foreseeable future, despite some verbal commitments at the level of the G-20 group of countries, second-best solutions for taxing financial transactions at the regional level were sought. In Europe, this culminated with the tabling by the European Commission of a proposal for a common system of FTT in September 2011. This proposal contained powerful anti-relocation mechanisms.

However, during the Council discussions, it became apparent that some Member States considered these anti-relocation features of the proposal as not being powerful enough and they feared of a massive relocation of financial activity to the benefit of non- or low-taxing third country jurisdictions and at the expense of their own financial centres and their own real economy.

Also, some Member States feared of negative knock-on effects of such a tax both on the efficiency of financial markets itself, on the non-financial part of the economy and on the overall growth and employment performance of their economies. The expected reduction in (virtual) liquidity triggered by the crowding out of certain business models (such as high frequency trading) or the discouragement of "internalisation" by market makers and broker dealers and the subsequent decline in market turnovers was seen as very problematic by these opponents of an FTT.

Some also considered action at the European level not being necessary at all and had a strong preference for co-ordinated or un-coordinated action at the national level by those that considered action necessary in first place, while other sceptical Member States might have accepted a common system of an FTT that would have been much narrower in scope and less ambitious in objectives.

As in the light of this very strict resistance by some Member States to the concept of tax harmonisation in this field at all the required unanimity in the Council was not reached in favour of the Commission's proposal for a Council Directive on a common system of FTT or for a variant thereof, the file was blocked at the level of the European Union for all 27 Member States.

In these circumstances, eleven Member States indicated that they wish to establish enhanced cooperation between themselves in the area of the establishment of a common system of FTT. This system should be based on the objectives and scope of the Commission's initial proposal. Moreover, special emphasis should be given to avoiding evasive actions, distortions and transfers to other jurisdictions.

3.2 EU right to act and subsidiarity

The right for the EU to act in relation to taxes on financial transactions is based on Article 113 of the Treaty on the Functioning of the European Union TFEU). The main rationale for EU

action is that the functioning of the Internal Market would be hampered if Member States decided to act unilaterally in this field. Ten Member States have introduced taxes on transactions in financial instruments; others are preparing the introduction of such taxes.[13] This uncoordinated approach fragments the EU financial market, distorts competition and increases the risk of relocation of financial activities both within and outside the EU. It also increases the risk that the financial sector becomes subject to double taxation or (unintentional) non taxation.

While neither the first-best solution to this problem (the introduction of a common system of financial transaction tax at the global level) nor the second-best solution (introducing this system at the level of EU27) had a chance of being achieved in a reasonable period of time the Commission received by 23 October 2012 the formal request by eleven Member States to launch the necessary steps for establishing the third-best solution (introducing this system at the level of enhanced cooperation zone referred to hereinafter as EU11+)[14]. According to the Commission's findings[15] these requests fulfil the legal preconditions as laid down in the EU treaties:

- Harmonisation of indirect taxation is an area covered by the Treaty which does not belong to the exclusive competences of the Union. And following an intensive discussion in the Council, it is clear that enhanced cooperation is a last resort solution to progress on this file;
- Harmonising a patchwork of different national taxes will not undermine the internal market. On the contrary, it will strengthen it by creating more coherence in the FTT jurisdiction and less administrative burden for business in EU11+ and beyond. Nor will this procedure undermine the single market or economic, social and territorial cohesion. Neither will it constitute a barrier to trade between Member States or distort competition between them;
- And finally, the procedure respects the rights, competences and obligations of non-participating Member States. They remain free to define and modify their own approach to financial sector taxation any time they want to without being hampered by the enhanced cooperation of those Member States that have chosen to go ahead on the basis of the objectives and scope of the Commission proposal of 28 September 2011.

Introducing a financial transaction tax at the level of individual Member States alone will not be successful in fully achieving the key objectives of such a tax. Neither will it ensure the proper functioning of the internal market and avoid distortion of competition, nor will it raise a fair and substantive contribution from the financial sector for covering the costs of the crisis.

It must be concluded that EU action through the procedure of enhanced cooperation would respect the subsidiarity principle since the policy objectives cannot be sufficiently achieved by actions of the Member States, and can be better achieved through coordinated action in the context of the Treaties of the European Union.

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[13] See Annex 1 for more details.

[14] Article 20 TEU stipulates that at least nine Member States must participate in a procedure of enhanced cooperation. In this document, the terms "EU11+", "EU11", "enhanced cooperation zone" and "FTT jurisdiction" are all used when referring to the group of Member States that participate in enhanced cooperation on FTT.

[15] COM(2012) 631.

4. OBJECTIVES

The initial proposal tabled by the Commission in September 2011 aimed at:

- Harmonising legislation concerning indirect taxation on financial transactions, which is needed to ensure the proper functioning of the internal market for transactions in financial instruments and to avoid distortion of competition between financial instruments, actors and markets across the European Union, and at the same time
- Ensuring that financial institutions make a fair and substantial contribution to covering the costs of the recent crisis and creating a level playing field with other sectors from a taxation point of view[16], and
- Creating appropriate disincentives for transactions that do not enhance the efficiency or stability of financial markets thereby complementing regulatory measures to avoid future crises[17].

Another aim had been to show to the rest of the world that such a tax could - against all odds - also work at the regional level and, thus, constitute a first tangible step towards a global solution.

Member States having requested receiving the authorisation for engaging in enhanced cooperation among themselves specified that <u>this cooperation should be based on the objectives of this initial proposal</u>.

From these general objectives of the initial proposal and from the context they were developed in, i.e. FTT at the regional level instead of the global level one can derive five principles with which the envisaged enhanced cooperation should stay in line:

- The common system should be designed in a way that there are no (significant) incidents of double taxation or unwarranted double non-taxation within the FTT jurisdiction. This would require that there should be no other (un-coordinated) national taxes levied on financial transaction covered by the FTT directive within the enhanced cooperation zone.
- The tax revenues collected should constitute a fair and substantial contribution from the financial sector for covering the cost of the financial crisis. Given that these costs (costs for public finances plus costs of economic losses triggered by the subsequent recession) are estimated to be in the order of magnitude of at least about 15% to 20% of the GDP of the EU (FTT jurisdiction)[18], the annual revenues raised should be in the order of magnitude of at least 0.3% to 0.5% of the GDP of the EU (FTT jurisdiction).
- The common system should not trigger a (significant) tax-induced geographical relocation of financial activity, neither within the FTT jurisdiction itself nor at the expense of the

[16] Some financial institutions, either directly or indirectly, largely benefited from the massive rescue and guarantee operations (pre)financed by the European taxpayer in the course of 2008 to 2012. These operations, together with the faltering of economic activity caused by the spread of uncertainty about the stability of the overall economic and financial system have triggered a significant deterioration in the public finance balances in many Member States. Also, most financial and insurance services are exempted from VAT.

[17] These disincentives through taxing certain activities and transactions are intended to reinforce the effectiveness of regulatory initiatives presently under preparation or having recently been implemented (see footnote 12). For the FTT initiative exercising such disincentives has more the character of welcome side effects.

[18] See also SEC(2011)1102.

financial centres of the FTT jurisdiction. Actually, participating Member States in their request specified that evasive actions, distortions and transfers to other jurisdictions should be minimized. This would require that all financial transactions that aim at serving the economy of the FTT jurisdiction should be taxed in case they

  - involve or serve the needs of financial institutions or other undertakings established in the FTT jurisdiction;
  - involve instruments issued in the FTT jurisdictions, or
  - are taking place in the FTT jurisdiction.

  For further dealing with the imminent risk of tax evasion and avoidance, especially in this very creative and mobile markets and actors, the principle of "substance over form" should apply in this context so as to minimize incentives for entering into legal constructs that aim at avoiding the tax without also changing the substance of the transactions in financial instruments undertaken.

- All financial instruments, actors and markets within the FTT jurisdiction should be treated similarly so as to avoid (significant) tax-induced distortion of competition or (significant) tax-induced substitution activities, such as shifting from taxed products or markets to non-taxed ones. This would require a non-preferential treatment of products, actors or markets, i.e. no exemptions for some products, actors or markets from being taxed[19].
- Pure rent-seeking financial intermediation, excessive risk taking and leveraging and that do not improve the efficiency or stability of financial markets should be discouraged[20].

The Commission had proposed that these principles and this scope of the FTT directive (notably the coverage of all actors, all markets and all products) should be implemented at the same time ("big bang") so as to achieve the commonly agreed objectives as soon as possible and so as to avoid substantive evasive action and distortion amongst actors, markets and products.

[19] However, this tax neutrality would not automatically mean that the effect of the tax on all market segments was aimed at being similar. Instead, due to the design of the tax it should be expected that certain transactions and business models, notably those undertaken at a very high frequency and building on very tiny margins or those characterised by a high leverage between the amount of the capital invested and the notional value of the underlying would be discouraged. This effect is actually warranted.

[20] See also SEC(2011)1102.

5. POLICY OPTIONS

The baseline scenario against which alternative policy options are to be benchmarked should be a situation where no agreement on a common system of FTT can be found, neither at the level of EU27 nor at the level of EU11+.

This baseline scenario is characterised by a variety of un-coordinated national regimes under constant change (as some Member States decided to change their systems or introduce new forms of FTT)[21], characterised in general by:

- The scope of the tax in most countries is rather narrow and generally covers the trading in securities (especially shares) on regulated markets only, with little or no taxation of derivatives[22] or over-the-counter transactions;
- Significant substitution of financial instruments, in order to avoid taxation;
- Specific exemptions of instruments and actors (e.g. for derivatives, shares/units of UCITS, market makers[23], broker-dealers etc.);
- The collection of the tax is usually done through intermediaries/brokers and the tax is typically not levied on both ends of the financial transaction.

In consequence, these taxes would generate rather little revenue. For example, the tax introduced by France in August 2012 is expected to generate about EUR 1.1 bn. or 0.06% of GDP annually. Assuming that the other participating Member States had introduced a similar tax on their territory, the annual aggregate revenue would amount to around EUR 4 to 5 bn. (0.06% of EU11+ GDP). This is far below what one would characterise as a "fair and substantial contribution" from the financial sector.

Moreover, the tax systems in place and under consideration in several Member States violate a basic principle of taxation that primarily aims at neutral revenue-raising, i.e. to treat similar events (actors, instruments, market places) in a similar way. This, in turn, triggers a distortion in competition both within individual Member States and within the Single Market.

So as to overcome these shortcomings of the baseline, different alternatives for action could have been envisaged:

- Option A: an FTT at the global level,
- Option B: an FTT at the level of EU27
- Option C: an FTT at the level of EU11+ through enhanced cooperation,
- Option D: an FTT co-ordinated outside the framework of the EU treaties.

However, option A had already been discarded at the time of tabling the initial proposal as – besides some lip-services and analyses undertaken in the run-up and as a follow-up to G20

[21] In the enhanced cooperation zone, three Member States have different forms of FTT in place, while at least three others are planning to introduce their own national schemes in the near future.

[22] The French system introduced as of 1 August 2012 specifically taxes also credit default swaps on sovereign government debt instruments. See Annex 1 for more details.

[23] According to Art. 4.1 of MIFID, a 'market maker' means a person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against his proprietary capital at prices defined by him.

meetings, there was no momentum at all visible that could have been interpreted as giving impetus to such an initiative. Also, by now and at latest in the aftermath of the Ecofin Council meetings of 22 June and 10 July 2012 in Luxemburg, option B has also to be discarded. It has become clear, and it was officially concluded at the meeting of 10 July 2012 by the (Cypriot) Presidency that no progress would be possible at the level of EU27 in the area of a common system of FTT.

Option D, in order to be meaningfully pursued, would require a critical mass of Member States (representing both economic weight and size of financial markets) to engage in developing a common system of taxing the financial sector. However, none of the Member States wanting to go ahead with a broad-based FTT was showing interest in such an approach outside the framework of the Treaties. Instead, they opted for officially requesting to be allowed to make use of the Treaty provisions for enhanced cooperation in the area of a common system of FTT, and based on the scope and objectives of the proposal tabled in September 2011.

Thus, only option C, i.e. establishing a common system of FTT under the procedure of enhanced cooperation can presently be assumed to have the potential of achieving the objectives outlined in chapter 4. In consequence, this paper analyses policy options and the impacts of a common system of taxation to be implemented in the enhanced cooperation zone that is based on the scope of the proposal already tabled in September 2011, composed of the following features:

- All financial instruments (shares, government bonds, derivatives, structured products etc.) as defined in Annex I, Section C of the Markets in Financial Instruments Directive (MiFID)[24], all financial institutions (including also other undertakings with significant trading in financial instruments) and all markets (organised and non-organised markets) are taxed;
- Taxation is based on strong anti-relocation mechanisms, such as a broadly-defined residence principle. Under this principle, it matters who is interacting with whom, independent of whether the place of transaction is within or outside the territory of the FTT jurisdiction, and independent of whether the instrument has been issued within or outside the FTT jurisdiction, for as long as one of the financial institutions involved in the transaction is deemed to be established in the FTT jurisdiction. Moreover, as this residence principle is defined in a rather broad manner, it also means that all transactions taking place in the FTT jurisdiction are to be taxed as well;
- The tax rates are rather low (0.1% of the consideration paid for trading in securities and 0.01% of the notional value of the underlying for derivatives), and the tax has to be paid immediately (so as to minimize cash-flow advantages for the taxable persons - and cash-flow disadvantages for the tax authorities). The revenues accrue to the Member States where the taxable financial institution is deemed to be established;
- The tax is to be paid at both ends of the transaction for as long as a financial institution is involved at the respective end. Joint and several liability is foreseen so as to improve tax

[24] Directive 2004/39/EC of the European Parliament and the Council, OJ L 145, 30.4.2004, p. 1.

compliance.[25] The actual enforcement of taxation is largely left to the discretion of Member States.

Alternative policy options could be based on variations of the above parameters, e.g. they could aim at a narrower base by exempting certain products, actors or markets, or by going for an alternative principle of taxation, e.g. based on the issuance or on the place of transaction principle instead of the residence principle, they could aim at taxing only one leg of the transaction or envisage more differentiated tax rates.

In the political discussion and in the discussions in the Council Working Party, all these variants have been raised and discussed, with a special emphasis on the following policy options:

- Exempting certain products, notably government bonds, the issue (and redemption) of shares and units of undertakings for collective investments in transferable securities (UCITS) and alternative investment funds (AIF), repurchase and reverse repurchase agreements, and derivatives agreements;
- Exempting certain actors, notably regional and multilateral development banks, public bodies of Member States charged with or intervening in the management of the public debt, market makers and broker-dealers, and fully funded pension funds or institutions for occupational retirement provisions (pillar II and pillar III pension funds);
- Complementing or replacing the proposed residence principle by the issuance principle or elements thereof;
- Changing the order of criteria determining the Member State in which a financial institution is deemed to be established and, thus, to which Member State the tax revenues would eventually accrue;
- Phasing in the FTT by initially starting with a narrower scope.

[25] While the construct of "joint and several liability" might theoretically be a source of some counterparty risk, this risk would be manageable as the reputation of the counterparty (reliable versus unreliable taxpayer) would be factored into the conditions of the contracts in case of certain over-the-counter transactions, while in the case of using trading platforms or clearing houses these latter might be used to collect and pay the tax to the tax authorities and, thus, minimize this counterparty risk.

6. ANALYSING THE IMPACTS OF DIFFERENT POLICY OPTIONS FOR A COMMON SYSTEM OF FTT UNDER ENHANCED COOPERATION

The first starting point for analysing different options for taxing financial transactions and their effects should be the impact assessment accompanying the initial proposal and complemented by the additional analysis undertaken and published since by the Commission[26], as the scope and objectives of the FTT initiative foreseen under the procedure of enhanced cooperation should be based on the scope and objectives of this initial proposal.

In a nutshell, this analysis found – as compared to the baseline scenario of no action at the EU level - very positive impacts on the functioning of the single market for financial instruments, namely the non-occurrence of any kind of double taxation or unintended double non-taxation, as well as very positive effects on public finances (additional annual revenue in the order of 0.5% of GDP). It was also found that the FTT system would trigger some rolling back of business models in financial markets that were mainly aiming at redistributing wealth and rents, even at the price of higher risk exposure, instead of creating wealth and values. Also, thanks to its powerful ring-fencing provisions (non-taxation of ordinary bank transactions such as providing capital to enterprises and private households), negative knock-on effects of the tax on the real economy could be largely avoided, the risk of geographical relocation could be minimized, while at the same time the proposed tax system was characterised by a high degree of tax neutrality across instruments, market places and actors within the financial sector.

6.1 The Commission proposal under enhanced cooperation (Option C)

The analysis referred to so far was based on a proposal for a common system of FTT for the entire EU (EU27) and not for a subset of Member States. Thus, in a first step, this initial analysis undertaken for a common system of FTT at the level of EU27 (option B) would need to be adjusted to take account of this narrower FTT jurisdiction (Option C), and changing outcomes would need to be highlighted. Three elements deserve special attention in this context: would EU11 instead of EU27 trigger different single-market effects (such as double taxation)? Would it result in different market reactions (such as turnover volumes, geographical relocation or additional substitution effects)? And finally: What is the revenue potential for a much smaller FTT jurisdiction?

6.1.1 The single market dimension (double taxation and double non-taxation)

It belongs to the nature of a process of enhanced cooperation in the field of taxation that it cannot succeed in avoiding all occurrences of double taxation within the European Union for as long as not all Member States of the European Union participate in this cooperation. This

[26] See http://ec.europa.eu/taxation_customs for links to the initial impact assessment, its summary and all its annexes as well as links to the additional analysis carried out by the Commission since September 2011.

holds the more as all non-participating Member States have the freedom to change at any time and in any direction the way how they tax financial institutions and financial transactions (including not taxing them at all) for as long as the tax regime chosen complies with the body of EU legislation and with international law.

Thus, while the initial proposal of the European Commission, if applied in all 27 Member States of the European Union would have succeeded in eliminating and avoiding any kind of double taxation of financial transactions and of a fragmentation of the Single Market with respect to taxation, the enhanced cooperation of the EU11+ group of Member States can achieve this in the FTT jurisdiction only. Thus, instead of 9+ systems of taxing financial transactions within the FTT jurisdiction there will be only a single system in place. This should avoid any kind of distortion of competition within the FTT jurisdiction.

Also, risks of delocalisation of taxed activities within the FTT jurisdiction could be assumed to remain rather limited[27] for as long as the directive will be transposed, implemented and enforced in a similar way in all participating Member States and for as long as differences in actual tax rates (the directive proposes minimum rates only) do not invite for tax planning triggering a relocation of activities. Actually, such residual risks could only be avoided in the context of a proposal for a regulation instead of a directive, and prescribing standard rates instead of minimum rates.

As regards remaining potential occurrences of double taxation between the FTT jurisdiction on the one side and non-participating Member States on the other side, this might be most evident with respect to those Member States that host very important financial centres and a relatively large financial industry. Non-participating Member States, such as Cyprus, Finland, Ireland, Luxemburg, Malta, Poland and the UK, have in place their own national taxes on financial transactions. However, these countries only apply rather narrowly defined taxes on securities transactions, with generously defined exemptions or exclusions from the scope of the tax for financial intermediaries.

Thus, some financial institutions (deemed to be) established in the FTT jurisdiction might have to pay both the FTT and tax in some of these non-participating Member States for the same financial transactions.[28]

However, these potential occurrences of double taxation should constitute only a tiny fraction of transactions for which the common system of FTT is designed, and this only in case these taxing but non-participating Member States were not to join the FTT jurisdiction at a later stage. A "second-best" possible solution (next to enlarging the EU11+ to EU27) for dealing with such remaining occurrences of double taxation would be the use of the instrument of bilateral double-taxation agreements.

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[27] However, see also section 6.4.4 for a more nuanced analysis of this.

[28] It is difficult to quantify the potential double taxation for example in the of the interaction with the UK system as no information is available on how much of the revenue from the UK Stamp Duty (SD) and Stamp Duty Reserve Tax (SDRT) is actually paid by financial institutions of the FTT jurisdiction. There are some estimations (Griffith-Jones 2012) indicating that about 40% of the SD and SDRT are actually paid by non-residents (to the UK). If about one quarter of these non-residents were financial institutions of one of the participating Member States, and assuming that the Member States of the FTT jurisdiction applied the minimum tax rate of 0.1% (as compared to 0.5% in the UK), then this occurrence of double taxation could be in the order of magnitude of about EUR 80 mn. (EUR 3.98 bn. * 40% * 25% * 20%) annually.

6.1.2 Market reactions (turnover, relocation, substitution)

The application of an FTT bears the intrinsic risk of agents "relocating" their activities to reduce the fiscal burden, independent of whether the jurisdiction applying this tax comprises the entire European Union or only parts of it. "Relocation" might take place by (i) moving the relevant activities to jurisdictions where they are taxed less, (ii) by shifting to products/suppliers outside the scope of taxation within the same jurisdiction e.g. by changing the business model or contract design, or (iii) abandoning the taxable activity altogether. In principle, this latter might even lead some products/markets to disappear in the medium and longer run, however, without necessarily undermining the efficiency of the market itself. Obviously, the risk of both physical relocation of markets/market players and migration to non-taxed products decreases the broader the geographic coverage of the taxes is and the broader their scope. Thus, the risk of geographical relocation might at first glance be somewhat higher for an FTT introduced at EU11+ instead of EU27, as the geographical coverage of its application is narrower.

However, it would eventually be the concrete design of a tax in combination with the presence or absence of transaction costs of relocation (i.e. the availability or not of cheap substitution possibilities) that will largely impact on the actual extent of relocation. The cases of Sweden and the UK, which both introduced a tax on financial transactions at national level but with different relocation effects, provide some evidence for this.

Also the responsiveness of traded volumes to taxes (and transaction costs in general) varies across products and markets, as it is heavily influenced by available substitution possibilities and the characteristics of the relevant trading platforms. Thus, the design of the tax will be as important as its rate or change in the rate.

The risks of geographical relocation, as well as those arising from potential migration towards untaxed substitute products, could be minimised by (i) not taxing certain activities at all (not really an option if one wanted to treat similar products similarly), by (ii) extending the geographical coverage of the tax and by (iii) including a wide range of financial products and markets (exchange and over-the-counter) in its scope. It can also be reduced by linking the FTT with some form of registration. Clearly, coordination in terms of products covered by the tax as well as of applicable tax rates is a prerequisite for lowering the incentives to relocation across jurisdictions.

Geographical relocation

So as to effectively avoid having to pay FTT it would not suffice that a financial institution simply moves its seat outside the FTT jurisdiction. This is, because for as long as a financial institution intends to either undertake transactions in the FTT jurisdiction or to serve a client base of the FTT jurisdiction it would be deemed to be established in the territory of a participating Member State (Article 3.1 of the initial FTT proposal – Article 4.1 of the new proposal). Thus, a financial institution would have to both abandon to trade on trading platforms in the FTT jurisdiction (this would also hold for the remote access to such trading platforms from outside the FTT jurisdiction) and to abandon all its clients in participating Member States if it wanted to avoid paying the tax.

Client base

Example1:

An American bank sells a derivative via an UK investment bank on a French trading platform to a German regional authority. The UK investment bank acts for the account of the German regional authority.

- FTT is due twice in Germany at the German rate as both banks are deemed to be established in Germany.
- If the notional value of this derivative was EUR 10 mn. and Germany applied the minimum rate of 0.01% each financial institution would have to pay EUR 1.000.

Example 2:

A French company asks a German bank which asks its American-based Investment Bank subsidiary (AS) to hedge a currency risk in the name of its parent company but for the account of the French company. For this, the American subsidiary (AS) enters into a derivative agreement in the name and for the account of the German bank with another American bank (AB) having no link to the territory of a Member State.

- FTT is due twice in Germany at the German rate as for this transaction the AS is deemed to be established in Germany and for this transaction the second American bank (AB) is equally deemed to be established in Germany. But as the AS was acting in the name of the German bank the tax would have to be paid by the German bank.
- If the notional value of this derivative agreement was EUR 10 mn. and Germany applied the minimum rate of 0.01% the German bank itself and the American bank (AB) would each have to pay EUR 1.000.

This very broadly defined residence principle distinguishes the actual design of the FTT as initially proposed by the Commission from the design typically analysed in studies preceding the Commission proposal, and highlighting the relocation risk in case an FTT was introduced at a sub-global level.

Thus, the risk of geographical relocation remains rather limited for both relocation to non-EU jurisdictions and relocation to non-participating Member States. So do the benefits of relocation. Also, there is no obvious mechanism that would invite for the conclusion that the risk of relocation to financial centres of non-participating Member States of the EU is higher than the risk of relocating to financial centres of non-EU countries, such as Switzerland, the USA or other well-established financial centres in the world.[29]

Substitution and changing business models

[29] However, see section 6.4.4 for a potential exception to this rule.

The Commission proposal is characterised by a very broad definition of transactions, instruments and institutions, as defined in Article 2 of the proposal of September 2011. This approach to cover all markets (organised and non-organised), all actors (from traditional financial institutions to big non-financial companies that undertake significant trading in financial instruments) and all products (shares, bonds, bills, derivatives, structured products etc.) was inspired by the invariable strive of market participants to minimize their tax burden and engage in economic activities that are either not taxed or less taxed. By the same token, it was also inspired by the need for preserving "tax neutrality" and not to discriminate against or to privilege certain actors, markets or products.

A significant share of the market reactions triggered by the introduction of this tax is assumed to be the result of actors replacing taxable events with (new) un-taxed business models, and deleveraging transactions. For example, the traditional way of brokering (where brokers buy and sell in the name or on account of other financial institutions) might replace the current practice of broker-dealers trade in their own name and on their own account as this would relieve them from paying the tax (see Art. 9.2 of the initial proposal[30]). However, as this change of business models would deprive the broker-dealers, market-makers and high-frequency traders of some rents (the so-called "internalised") they might only abandon this business model for those transactions where these "internalised" spreads allowed by the market would be smaller than the tax they would have to pay.

In the present business model of transaction chains being dominated by such "market-making" and "internalisation" proprietary trading by all actors, each transaction shows up (in the statistics of market turnover) as a buying and selling transaction, i.e. a single purchase/sale operation triggered from outside the financial sector might (statistically) show up as two, three or even four trades at each side of the transaction. Once such proprietary trading will turn into taxable events the trading might – depending on the size of the internalized spread - be replaced by "intermediation". So, while "trading" turnovers will decline, the initiating underlying economic substance (one actor wants to buy and get ownership of a product and one other wants to sell and dispose of this ownership) remains unchanged, and the potential cascading effect of the tax within a single transaction chain can be avoided.

Brokerage and market-making services – the "internalisation" of spreads

Example 1:

A Belgian and a French private household use respectively their Belgian and French retail banks and order them to buy/sell on the Paris stock exchange, in the name or for the account of the respective households, shares of a French joint-stock company in the value of EUR 10.000. The retail banks pass on these orders to their wholesale banks and those to their brokers on the Paris stock exchange. All three intermediate only, without buying or selling for their own account.

- Both retail banks are liable to pay the FTT due in their country of establishment (Belgium and France respectively). Neither the wholesale banks nor the brokers are liable to pay

[30] Art. 9.2 of the initial proposal read: "Where a financial institution acts in the name or for the account of another financial institution only that other financial institution shall be liable to pay FTT."

FTT.

- The retail banks would have to pay EUR 10 each for this transaction in France and Belgium respectively. The effective tax to be paid by all actors in the whole transaction chain corresponds to 0.2% of the economic value of the transaction.

Example 2:

Same case as example 1, but, this time, the shares are passed on through five successive sales and purchase ("internalisation" of spreads): Apart from the two retail banks, who act in the name or for the account of the respective households, all other participants act in their own name and for their own account as well.

- All six financial institutions are liable to pay FTT in France and in Belgium respectively. Both brokers and both wholesale banks have to pay FTT twice, while the retail banks have to pay only once.
- The brokers and wholesale banks would each have to pay EUR 20 and the retail banks each EUR 10. The effective tax to be paid by all actors in the whole transaction chain would correspond to 1.0% of the economic value of the transaction.

It is assumed that financial institutions will not ignore the tax when developing and implementing their business strategies. However, this should not be confused with less efficient markets or an unwarranted squeeze in liquidity in affected markets.

In this economic analysis it is also assumed that the reduction in market volumes is partly the result of the rolling back of certain high frequency but low-margin transactions which would no longer be attractive for the transaction partners once a tax of 0.1% or 0.01% is levied. Thus, it is assumed that in some market segments the tax will create a structural break in the sense that business models change (e.g. in the field of automated High Frequency Trading and high-frequency δ-hedging) which leads to fewer transactions and potentially other ways of trading assets and shifting risks.

6.1.3 Revenue estimations

When presenting and reading revenue estimations for taxes which would be newly introduced or where the tax base is substantially broadened or changed and that – on top of this – have to a certain extent the goal to change market behaviour and market structure bears a high degree of uncertainty. For the initial proposal of the draft directive, and at a tax rate of 0.1% for securities and of 0.01% of the notional value for derivatives agreements and payable by each side of a transaction, the revenue estimates for the tax about EUR 57 bn. annually for the entire European Union, with about EUR 19.4 bn. stemming from the taxation of transactions in securities and about EUR 37.7 bn. stemming from the taxation of derivatives[31].

These estimations took as a starting point a bottom-up approach based on the "place of transaction" principle, by looking at the cumulated turnover in (taxable) financial transactions in all Member States of the European Union. Such an approach would only reflect to match the proposed tax design in case all transactions in Europe were actually transactions between

[31] See SEC(2011)1102, and the additional analysis published on the FTT-dedicated page of the European Commission.

European financial institutions, or where at least one party to the transaction was a financial institution deemed to be established in the EU. However, this assumption is not expected to hold, mainly for two reasons:

- Under the proposal for EU27 it was foreseen that also transactions carried out outside the EU should be taxed for as long as one of the parties or one of the financial institutions involved is deemed to be established in the EU. Thus, an estimation only taking into account transactions carried out within the EU would tend to underestimate potential revenues of the proposed FTT.
- On the other hand, there is also a part of the turnover in financial instruments in Europe where a European party is acting in the name or for the account of a non-European party. An estimation also taking into account these transactions would tend to overestimate the revenue potential of the proposed FTT having in mind the exemption in Art. 9.2 of the original Commission proposal.

As both effects tend to work in opposite directions, it could be reasonably assumed that revenue estimations at the aggregate level taking the cumulative turnover at the place of transaction in all Member States could serve as a proper proxy for the potential revenue at the aggregate level of the FT proposed.

What might still work at the aggregate level will, nevertheless, be less and less acceptable as a proxy the more one disaggregates, as cross-border transactions are becoming more and more important. Instead, one would first have to identify the financial institution that is the person liable to pay the tax, for instance, with the help of the Markets in Financial Instruments Directive (MiFID)[32] and the European Markets Infrastructure Regulation (EMIR)[33]. Then, due account would have to be taken of the provisions of "establishment" of the proposal as well as of the provision according to which in cases "where a financial institution acts in the name or for the account of another financial institution only that other financial institution shall be liable to pay the tax." Such comprehensive data mining and analysis was not possible as most of the data needed for this are not yet public.

Also, such an approach would not have resulted in an accurate reflection of the market structures and involvement of participants once the tax will have been introduced, as it would not have been possible to assign to individual actors the potential market reactions, behavioural changes and changing business models expected to be triggered by the levying of the tax. As these market reactions were assumed to be rather significant (minus 15% the trading in securities and minus 75% for the derivatives markets, such dynamic developments would to a certain extent substantially alter the results of the ex-ante data mining, and could not have been ignored when estimating the regional incidence of the tax.

When adjusting the revenue estimations to the new FTT jurisdiction comprising 11 countries one has, once again, to work with proxies. In the light of the methodological difficulties proxies could be used that correlate the volume of taxable transactions with different parameters, such as:

- the size of the economies of the FTT jurisdiction, measured by the GDP of the economy (either in current prices terms or expressed in purchasing power standard);

[32] Directive 2004/39/EC of the European Parliament and the Council, OJ L 145, 30.4.2004, p. 1.

[33] Regulation 2012/648/EC of the European Parliament and the Council on OTC derivatives, central counterparties and trade repositories, OJ L 201, 27.7.2012, p. 1–59.

- the size of the financial sectors of participating economies, measured by the value added of the sector before taxes (the sum of profits and the wage bill or the net operating income).

The first proxy is based on the assumption that the need for (taxable) financial services increases and correlates with the size and wealth of an economy: the bigger and richer an economy, the more (taxable) financial services it requires. It also assumes that the share between taxable financial services (trading in securities and conclusion of derivatives agreements) and non-taxable financial services (such as bank or mortgage loans) is similar in all countries and does not change with the wealth of a nation. It also assumes that the share between the different taxable financial services (notably trading in securities on one side and the conclusion of derivative agreements on the other) is similar across Member States. In 2011 both the GDP at current prices and in PPS of the EU11 represented 66.4% of the EU27 GDP. On that basis, and taking as a basis the revenue estimations for EU27 as developed in the initial impact assessment, the total amount of revenues for the EU11 would be approximately EUR 38 bn.

However, such a proxy would largely ignore that some economies (such as the UK or Luxemburg) have to a certain degree specialised in the provision of financial services, or that have financial institutions with large portfolios and assets available for trading etc. In order to take such specialisation into account, the size of the national financial sector (as e.g. measured by the net operation income in the EU banking sector) in the overall European financial sector[34] could be considered as well. By using such a proxy it would on the one side be assumed that bigger financial institutions of the FTT jurisdiction are also more involved in (taxable) transactions in financial instruments than smaller institutions. On the other side, such a proxy would also – at least partially – cater for the assumption that in non-participating Member States with large financial centres there are more transactions that are exclusively undertaken between or on behalf of actors of these economies and third countries, and that are, thus, falling outside the scope of the proposed FTT regime. In 2011, the size of the banking sector (as measured by the net operating income) of the EU11 represented 59.8% of the total EU27 size. On that basis, and taking as a basis the revenue estimations for EU27 as developed in the initial impact assessment, the total amount of revenues for the EU11 would be approximately EUR 34 bn.

This second proxy, based on the shares of the banking sector, appears to be more accurate considering that important EU27 financial centres are not covered by EU11, and the revenue-raising potential according to this proxy will be used henceforth. However, when using this proxy as a basis, one should be conscientious of the fact that the underlying parameter (net operating income in the EU banking sector) is much more volatile that the parameter underlying the alternative proxy (GDP). On the basis of this proxy it is estimated that a EU11 FTT would produce EUR 34 bn. of tax revenues for the participating Member States.

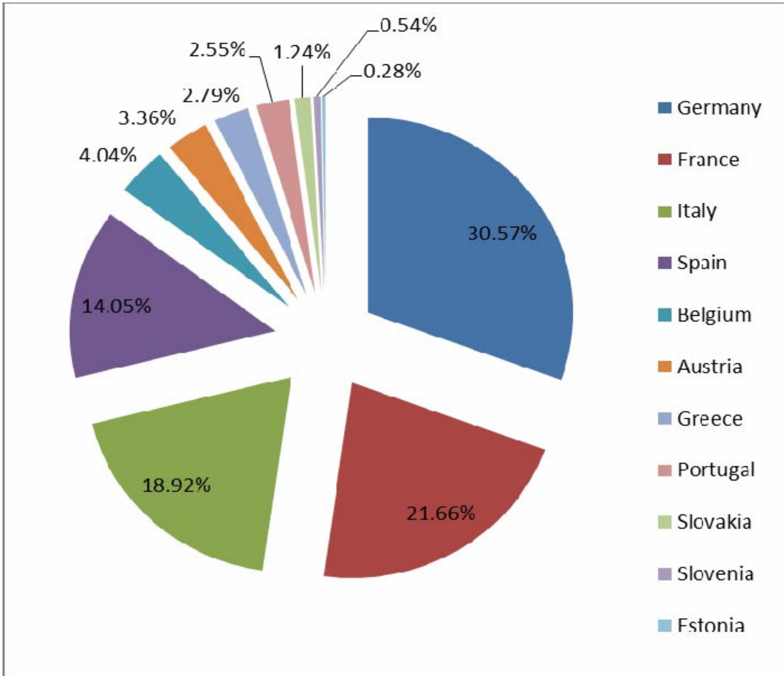
Whatever of these two proxies used, the amount of revenues represents around 0.4% of the EU11 GDP. This result is somewhat smaller than the relative size of revenues expected for a

[34] This indicator (ECB data, 2011) is expected to be representative as the banking sector represents around 73% in terms of assets of the "classical" financial sector (banking, insurances, investment funds and pension funds). It was not possible to take into account what is designated as the "shadow-banking" sector, which is estimated to correspond to approximately 59% of the banking sector in terms of assets. For more details, see ECB (2012) – Shadow banking in the euro area - An overview (occasional paper).

EU27 implementation, but still looks plausible, especially when taking into account that certain important financial centres in the EU (such as Luxemburg and the UK or Ireland) are not (yet) part of the FTT jurisdiction for the moment.

Considering the arguments developed earlier in this section (difficulties in catching market structures and dynamics after the introduction of the tax and disaggregating cross-border transactions), it is hardly possible to estimate the individual participants' share of revenues within the limits of an acceptable margin of error. However, if one assumed that the share of each participating Member State in total revenues correlated with the size of their underlying economies, the following pie chart could illustrate what this would mean for each Member State. Taking as total revenue the sum as indicated by proxy 2 (EUR 34 bn. annually) the amounts could range from EUR 95 mn. for Estonia to EUR 11.75 bn. for Germany.

Chart 1: Breakdown of revenues in the EU11+ according to GDP in PPS (2011)



As prone with difficulties as estimating total revenue and their breakdown by country is the breakdown by product category. However, when taking the revenue estimations and the breakdown of revenues per product category of the findings of the impact assessment accompanying the initial proposal as a starting point, one could arrive (at least for illustrative purposes) at a breakdown as presented in table 1.

Table 1: Revenue estimations by product group (in EUR bn.)

	EU27	EU11
Securities	**19.4**	**13.0**
- shares	6.8	4.6
- bonds	12.6	8.4
Derivatives	**37.7**	**21.0**
- equity linked	3.3	1.8
- interest rate linked	29.6	16.5

- currency linked	4.8	2.7

The breakdown in table 1 for securities is based on the assumption that the share of revenues generated by taxing the trading in securities (shares and bond) for EU11 corresponds more or less with the share of the EU11 economy in EU27 GDP, as securities trading might correspond more with the size of the underlying economy than with the size of the financial sector. This assumption then gives total revenues from taxing the trading in securities of EUR 13 bn. for EU11.

The remainder of the total revenues of EUR 34 bn. is then allocated to taxing derivatives products, and proportionate to what had already been estimated for EU27. This approach reflects that key financial centres of the EU and also specialised in derivatives trading such as the City of London are for the time being located outside the FTT jurisdiction.

6.2 Sub-Option 1: Exempting certain products[35]

The initial proposal stipulates that the proposed directive shall apply to all transactions in financial instruments, on condition that at least one party to the transaction is established in a (participating) Member State and that a financial institution established in the territory of a (participating) Member state is party to the transaction or is acting in the name of a party to the transaction.

A financial transaction is defined as any of the following:

- The purchase and sale of a financial instrument, including securities lending and borrowing;
- The transfer between (legal) entities of a group of the right to dispose of a financial instrument as owner and any equivalent operation, and
- The conclusion or modification of derivatives agreements.

However, primary market transactions, i.e. the issuance of shares and bonds are excluded from the scope of the directive so as not to tax the raising of capital.

Financial instruments covered by the directive are in principle all kinds of securities (such as shares, bonds and structured products, money market instruments, units/shares of UCITS and AIF and derivatives). This guarantees a very broad tax base, fiscal neutrality between the different products as well as a minimization of tax evasion through substituting transactions in one product category by transactions in another product category.

However, concerns were raised that taxing transactions in some instruments and products would either be in contradiction with the body of existing EU legislation or that it could have negative side effects that would outweigh the benefits of raising revenue or discouraging high-risk or socially useless transactions and should, thus, be avoided. This held namely for (i) the taxing of the issue and redemption of shares and units of UCITS and AIFs, (ii) the taxing of the transactions on secondary markets for government bonds and bills, (iii) the taxing of repurchase and reverse repurchase agreements, and (iv) the taxing of derivatives.

[35] Adding certain products, notably spot currency transactions, has also been raised and discussed as an option in the Working Party of the Council. However, as according to the Commission such a spot currency transaction is not a transaction in a financial instrument but simply a capital movement (like a payment) and as taxing this capital movement would not comply with Article 63 TFEU, this option is discarded.

6.2.1 *UCITS and AIF*

Units of undertakings for collective investments in transferable securities (UCITS) and alternative investment funds (AIF) are important investment vehicles used both by the non-financial economy as well as by institutional investors, such as pension funds, banks, insurance companies or other UCITS and AIF. These investors have the possibility to buy shares or units of the UCITS and give them back at a later stage. In the EU, these UCITS and AIF manage assets worth more than EUR 11 tn., of which UCITS manage about EUR 5.8 tn.[36] The corresponding figures for EU11+ would be EUR 3.74 tn. and EUR 1.97 tn. respectively[37]. UCITS and AIF can raise capital by issuing shares or units giving the owner of these shares and units the right for fixed or variable benefits, and the right to redeem these shares or units at any given time. In 2011, UCITS experienced net outflows of EUR 88 bn. and EUR 29.9 were outstanding in EU27 and EU11+ respectively (redemptions were superior to sale/issuance of shares/units)[38]. In 2011, UCITS have issued and redeemed shares and units worth EUR 15,485 bn. in EU 27 and EUR 5,264.9 bn. in EU11+ respectively[39].

While the redemption of such shares or units can be easily interpreted as a transaction on a secondary market, the issue of shares and units of UCITS and AIF can be interpreted as both a transaction on a primary market so as to raise capital to work with and as a transaction on a secondary market when shares or units, having been redeemed by previous investors, are resold to new investors.

In case such issuance was to be seen as a transaction that aimed at raising capital such issuance should not be taxed according to Directive 2008/7/EC. In case such issuance was, however, to be seen as a transaction on a secondary market for shares and units in UCITS and AIF this issuance should be treated the same way as the trading in shares and bonds of other undertakings so as to preserve fiscal neutrality across products. This part should then be taxed. However, and in contrast to the issuance of shares and bonds of other undertakings, it is not clear to what extent the issuance of a specific share or unit in UCITS and AIF is actually linked to the (non-taxable) raising of capital or to the (taxable) trading on secondary markets.

- ➢ In order to respect the provisions of Directive 2008/7/EC and for reasons of tax neutrality, the issue of shares and units of UCITS and AIF should not be taxed. As a consequence, annual revenues would be around EUR 4 bn lower as compared to a situation where this issuance was taxed.

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[36] EFAMA (2011) – EFAMA's impact analysis of the Commission's proposal for a Council Directive on a common system of financial transaction tax.

[37] EFAMA (2011) – Asset management in Europe. Facts and figures. Own calculations show that the share of the EU11 in the total UCITS assets in the EU is around 34%.

[38] EFAMA (2011) – Quarterly statistical release.

[39] EFAMA (2011) – EFAMA's impact analysis of the Commission's proposal for a Council Directive on a common system of financial transaction tax, Annex I.

6.2.2 Government bonds (and bills)

As already stated in the Impact Assessment accompanying the initial proposal[40], at a tax rate of 0.1% for securities the revenue estimates for the bonds taxation is about EUR 12.6 bn. At least three quarters of these revenues, which is around EUR 9.5 bn., was expected to be generated by taxing trading, borrowing and lending in government bonds. The corresponding figures for EU11 are estimated to be EUR 8.64 bn. and EUR 6.51 bn. respectively.

The increase in the transaction costs in the secondary market following the implementation of a transaction tax on government bonds trading may impact on the primary market by increasing the interest rates to be offered for newly emitted public bonds, therefore implying an increased cost for public budgets. According to modelling simulations undertaken by the Commission[41], the increase in the cost of capital following the introduction of the tax could be about 0.07%. If this rate of increase was applied to the issuance conditions of Government bonds and bills and considering the overall EU27 and EU11 outstanding government bonds of around EUR 8.1tn. and EUR 5.5 tn., respectively[42], the initially modelled increase in the cost of the debt would be about EUR 5.6 bn. and EUR 3.85 bn. respectively.

However, these estimations do not take into account some mitigating effects:

- First, the exclusion of primary markets from the scope of the tax will make this primary market more attractive, especially for institutional investors that pursue a "buy and hold strategy", i.e. once they have bought a bond or bill they will hold it until maturity. Also, other investors might start preferring primary over secondary markets as the first are after all tax free. The resulting higher supply of lending capital on the primary market should exert a downward pressure on borrowing rates, which could partially compensate for the upward pressure following the introduction of the tax in the secondary market. This should in principle have a moderating impact on the cost of borrowing for governments;
- Second, interest rates for primary markets for outstanding debt (debt already issued) and, thus, the cost of the outstanding debt will not be affected by the tax. At the same time the taxing of the trading in outstanding government bonds (and bills) will generate substantial revenue. This is especially interesting for highly indebted countries. Only when it comes to rolling over this debt, which will typically take some years, conditions on the primary market for this debt might be affected as well;
- Finally, as the net revenues accruing to the public budgets will help to sustain the process of budget consolidation, this will also contribute to the easing of the issuance conditions in the longer term and therefore induce a decrease of the cost of borrowing for public funds.

If one estimated these mitigating effects to half the modelled predicted increase in the cost of capital (to less than EUR 2 bn.), the net return of taxing the trading in government bonds based on the initial revenue estimates (2011) would amount to about EUR 4.5 bn. For EU11+, in other words: for each euro potentially to be spend on higher interest rates governments would receive more than three euro in return in form of higher FTT revenue (gross revenue:

[40] See SEC(2011) 1102.

[41] See ECFIN(2012) – Securities Transaction Taxes: Macroeconomic Implications in a General-Equilibrium Model (economic paper by Rafal Raciborski, Julia Lendvai, Lukas Vogel)

[42] ECFIN/EFC Subcommittee on bonds and bills (2012) – Total government debt securities outstanding.

EUR 6.5 bn., higher borrowing cost: EUR 2 bn., net revenue: EUR 4.5 bn.). As a result, the net budgetary implication of taxing the trading of Government bonds will remain highly positive, even when considering a measurable indirect impact of the tax on the primary market. This notably tends to hold for highly-indebted countries.

- Exempting government bonds would not only negatively affect the tax neutrality of the proposed approach but it would also have considerable negative revenue implications for those countries doing so. It will also jeopardize achieving the objective of ensuring a fair and substantial financial contribution to covering the costs of the recent crisis, as it could be expected that the (gross) revenues from the financial sector would be reduced by about EUR 6.5 bn. by such an exemption.

6.2.3 Repurchase agreements

Repurchase agreements typically serve as cash management tools in the interbank market and also substitute for corresponding transactions with central banks, as the latter are typically offered at less attractive terms. A repurchase agreement is equivalent to a spot sale (of a security) and a forward contract, and it is economically similar to a (securities) secured loan. A reverse repurchase agreement is the same repurchase agreement from the buyer's viewpoint.

Such transactions are to be taxed as they comprise a sale and purchase of securities. However, they could easily be substituted by an economically rather similar secured loan, which would not be taxed (see box) or by an untaxed transaction with the central bank.

Repurchase agreements

Example 1:

A bank established in France lends "over-night" EUR 10 mn. to a bank in Italy (possibly backed up by securities as collateral).

- No FTT is due as outright lending and borrowing is out of scope of the FTT.

Example 2:

A bank established in France buys "over-night" EUR 10 mn. of French government bonds from a bank established in Italy and sells them back the next day (repo transaction):

- FTT is due both in France and in Italy for each transaction (Art. 2.1).
- As the market price of the transaction is EUR 10 mn., and as there are two transactions, each bank has to pay EUR 20.000 FTT in their country of establishment if both countries applied the minimum rate.

Example 3:

A bank established in France lends shares (with a market value of EUR 10 mn.) of an Italian listed-stock company to a bank in Italy. In accordance with the agreement, the shares are returned to the lender after three months. The lending fee is EUR 10.000.

- FTT is due both in France and Italy (Art. 2.1).
- As the market value of the shares is EUR 10 mn. both the French and the Italian bank would have to pay EUR 10.000 FTT in case both France and Italy applied the minimum tax rate.

In 2011, repurchase agreements had a market turnover of about EUR 6.18 tn. in Europe[43], and of about EUR 3.5 tn. in EU11+[44]. Theoretically, and as each repurchase agreement consists in principle of two purchase and sale transactions, taxing such a market volume could generate annual tax revenues in the order of EUR 17.6 bn. and EUR 10.5 bn. for EU27 and EU11+ respectively, assuming that 87.5% are transactions inside a year (and 100% transactions with at least one financial institution involved[45]), no market reaction, a tax rate of 0.1%, a transaction cost of 0.6% and tax elasticity of -1.5. If economic agents replaced repurchase agreements by a combination of spot sales and forward contracts or by another type of untaxed contract (for instance, a market reaction of 40%), and as forward contracts were derivatives to be taxed at a rate of 0.01%, potential tax revenues from repos would go down from EUR 17.6 bn. for EU 27 and EUR 10.5 bn. for EU11+ annually to EUR 10.3 bn. and EUR 6.1 bn. respectively when taxing two transactions. In the theoretical case such repurchase agreements were entirely replaced by secured loans, potential tax revenues would disappear altogether.

Not taxing repurchase agreements would harm fiscal neutrality in so far as a combination of spot sales (purchases) and forward contracts as well as securities lending and borrowing would be taxed while repurchase agreements would not. Also, it could entail foregoing significant revenues for public budgets, depending on the market reaction to the imposition of such a tax on repurchase agreements. Taxing them as two transactions, on the other hand, would in a way discriminate against repurchase agreements, e.g. as compared to securities lending and borrowing. Taxing only one transaction, for instance, with a market shift of 40% in volumes would yield only EUR 5.1 bn. for EU27 and EUR 3.0 bn. for EU11. Taxing 'over-night' repurchase agreements for example would make this business model unattractive, even when taxing them as one transaction only. Indeed, repurchase agreements would in all likelihood either be replaced by securitised lending operations or by transactions with a central bank, in case the securities offered were of sufficient quality for being accepted by a central bank and for as long as the terms offered by central banks were attractive enough. However, not taxing 'over-night' repurchase agreements could constitute a loophole also for repurchase agreements with a longer maturity as it might be rather easy to design them in a way so as to also qualify for the 'over-night' exemption. Thus, effective tax avoidance provisions would need to be put in place so as to close this loophole.

In the revenue estimations of the impact assessment accompanying the initial proposal (2011), it was assumed that all (taxable) repurchase agreements would be replaced by (non-taxable) securitised loans. This assumption could be considered to be realistic to a certain extent for 'over-night' repurchase agreements which cover the largest part of the market[46]. However, for agreements with a longer maturity the default risk of the counterparty might provide an incentive for maintaining the initial business model even in the presence of a tax.

[43] International Capital Market Association (2011) – European repo market survey.

[44] This is an estimate made using the share of EU11 in the EU27 according to the net operating income of the banking sector.

[45] The Impact Assessment accompanying the initial Commission proposal (2011) assumed that 85% of the financial transactions involve at least one financial institution, besides a party located in the EU, which are therefore subject to taxation.

[46] International Capital Market Association (2011) – op. cit.

6.2.4 Derivatives

Over the last three decades, it has namely been the market for derivatives where turnovers have grown exponentially, and most of the detachment of the turnovers on financial markets from the growth of the real economy has been taken place in derivatives markets. Indeed, while the size of the global economy about doubled over the last three decades, the turnover on financial markets grew exponentially.

While these derivatives had initially been an instrument for hedging and risk management, they have more recently also become widely traded financial assets in their own. In consequence derivatives based on financial instruments are now dominating the market as compared to previous decades where the derivative contracts had been more based on agricultural products, precious metals, energy products or currencies. This has also brought concerns related to increased systemic risk because of the leverage inherent to the use of derivatives.

It can therefore no longer be taken as granted that all this financial intermediation in the domain of derivatives markets really serves the purpose of "oiling the wheels" of the economic fabric. Instead, it is safe to assume that significant parts of this intermediation serve the purpose of generating rents for the financial industry and at the expense of the non-financial economy as each individual intermediation comes at a cost, eventually to be shouldered by the non-financial part of economy.

Most countries having a kind of financial transaction tax typically apply it to the trading in securities only (thus they have a securities transaction tax – STT – instead of an FTT) and less frequently to derivatives as well[47]. This is for different reasons, the most important of which are: the mobility of the tax base, the difficulty in defining a proper taxable amount, the fact that most of the high-volume / high-value derivatives agreements are concluded over the counter and the reluctance of taxing risk-hedging activities having as a purpose to "oil the wheels" of the real economy.

However, this reluctance in taxing derivatives had some inconvenient side effects (besides foregoing substantial tax revenues) as it first led to a privileged treatment of such derivatives and second, as it nurtured the rapid growth of business models aiming at tax-avoidance, such as the emergence of tax-free "contracts for difference" instead of (taxable) trades in the underlying shares.

Also, competent authorities will have access to information on trading in different markets through the use of key financial market legislation in force, such as MiFID or EMIR. This is complemented by specific provisions in the proposal for a directive implementing enhanced cooperation in the area of FTT.

Finally, the fear that reduced market volumes in derivatives markets would harm the efficiency of financial markets, would increase the volatility on such markets and would make it more difficult for the non-financial and financial industry to hedge risks look largely unfounded. Instead, this rolling back of (inflated) market volumes might to a large extent boil

[47] Member States currently have limited taxes on some derivatives, while options are taxed in most of the Member States when they are exercised, resulting in the physical delivery of the underlying securities.

down to a statistical effect, and a drying out of the rent-generation business models for the financial sector itself.[48]

Indeed, the main reason for the assumed decrease in derivatives turnover is that it is the notional value of derivative transactions that is taken for measuring trading volumes and the market size. It is not the economic value which is, by the way, often very difficult to determine, both ex ante and ex post. It is also the notional value that is the tax base for the taxation of the derivative, mainly for reasons of administrative ease and cash-flow considerations. Given the large difference between the notional value and the economic value it is reasonable to expect that – through changing business models or because the economic value of a transaction is that small that it is not considered worth to pay a tax on this - turnover measured in notional values is expected to shrink significantly.

Risk hedging volumes

Example:

A trader exposes himself to a high nominal risk (e.g. EUR 50 mn.) and then hedges the biggest part of this risk accordingly by also taking the opposite risk (e.g. in the order of EUR 40 mn), so that the net risk exposure would effectively be limited to the difference between these two positions (EUR 10 mn. in this case).

- The introduction of a tax on the notional value of the underlying would provide incentives to go for the net risk only, i.e. EUR 10 mn., as this institution would then not have to pay an FTT of EUR 9.000 (for a notional value of EUR 50 mn. + EUR 40 mn.) but only EUR 1.000 (for a notional value of EUR 10 mn.)
- Statistically, the turnover volumes would have declined by almost 90% as the new turnover would only be EUR 10 mn. instead of the previous EUR 90 mn.

When determining the tax rate for derivatives, one has to keep in mind that investing in derivatives and investing in the underlying asset are to a certain extent different activities, especially with respect to the leverage effect of the capital invested. It is thus proposed to set the tax rate for derivatives at a tenth of the rate for securities.[49] As a consequence, the tax rate for derivatives renders derivative agreements with a leverage factor of less than ten relatively attractive, i.e. where the capital to be invested will be more than 10% of the notional value of the underlying.

Delta hedging

Delta hedging is a (usually) dynamic process where an investor continuously hedges an open position from an option by buying the underlying assets (or other derivatives closing the position). In option pricing models, the Greek letter delta is used to describe the sensitivity of the price of an option to a change in the underlying asset. The value is derived from the application of option pricing models. For example, a delta of 0.6 indicates that the option price increases by 0.6 Euro if the asset price increases by 1 Euro.

[48] As a consequence of the assumed decline in market volumes by about 75%, the notional value of contracts needing the management of market or counterparty risk, such as the novation through Central Counter Parties, portfolio compression in case of not centrally cleared OTC contracts or the exchange of collateral in the context of the management of derivative contract should decline correspondingly.

[49] Alternatively, one could set the tax rate at the same level as the one for securities trading while taking as the taxable amount only one tenth of the notional value of the underlying.

Take the following example for a hedge from Hull (2006). Assume an initial share price of 100 Euro and an option price of 10 Euro (100 shares per option). An investor sells 20 option contracts each on buying 100 shares (2000 shares in total). Delta is assumed to be 0.6. If the share prices decreases by 1 Euro, the value of the options decreases by 2000*0.6=1200. In order not to be exposed to this risk, the investor could buy 1200 shares of the underlying. In that case the price increase in the shares (+1200 Euro) equals the loss of the value of the options. The investor is said to be in delta neutral position since the total delta from his short position (option, -1200) and the long position (shares, +1200) is zero. Note that such a hedge also works the other way round, e.g. an investor with opposite positions would hedge accordingly. Also, instead of buying the underlying the investor could buy other derivatives closing the position.

A financial transaction tax as proposed by the Commission will increase the cost of delta hedging. In the example above, the tax is levied at least two times: When the options are sold (underlying: 200,000 Euro * 0.01% = 20 Euro), when the underlying is bought to hedge (120,000 Euro * 0.1% = 120 Euro), or – alternatively – when the position is closed (120,000 Euro * 0.01% = 12 Euro). If at the end of the option contract shares are exchanged as well, the tax would be due again on the price of the actual exchange value of the shares. Thus, the investor might not have an incentive for hedging changes in his position (delta) that were below 0.1% (in case he hedged by buying the underlying) or 0.01% (in case he hedged by closing the position. In case the counterparty was able to pass on its increase in transaction costs, the thresholds for hedging would increase to 0.2% and 0.02% respectively.

Note that this simple textbook example is static in the sense that only one hedge is considered. In reality, (large) investors hedge dynamically by controlling the evolution of delta for the whole portfolio continuously and adapting hedges accordingly. The real tax burden will depend on the specific hedging strategies employed.

By contrast, those contracts where this ratio falls below 10% will be less attractive. Thus, derivatives implying a hedging of very small and tiny risks (that means, the premiums to be paid are very small as compared to the notional value) or small and tiny changes in the risk (e.g. in the case of the so-called "delta-hedging" – see box) will be discouraged. This should significantly reduce the volumes and frequency of risk-hedging activities without necessarily triggering a higher risk exposure in the long run. This should also be expected to happen to the volume and frequency of transactions which are "speculative", i.e. where the actor invested little money so as to gain a lot, but with a small likelihood. Also, "excessive" financial intermediation in risk-hedging activities will be discouraged, and, thus, letting these activities fall more in line with the risk-hedging needs of the non-financial economy.

- Given (i) the high revenue-raising potential from taxing these products (EUR 21 bn. out of a total of EUR 34 bn.), (ii) the massive tax avoidance loopholes generated by not taxing these products and (iii) the contribution taxing these products for achieving the objective of discouraging transactions that do not contribute to the efficiency and stability of financial markets and that primarily aim at redistributing values instead of creating them, it can hardly be recommended not to tax derivatives.

6.2.5 Conclusion

Exempting certain products from the scope of the common system of FTT would have significant negative repercussions for the achievement of the key objectives of the initiative. It would notably:

- jeopardize achieving the aimed-at tax neutrality of the initiative as it would trigger distortions between different products (and actors) in the Single Market,
- jeopardize the achievement of the goal of receiving a fair and substantial contribution from the financial sector to covering the cost of the recent crises. This would also jeopardize achieving the goal of consolidating public budgets or to generate revenues for growth-enhancing public investment,
- jeopardize the achievement of the goal to contribute to a better functioning of financial markets. This holds especially when one decided not to tax derivative contracts or high frequency trading.

On the other hand, taxing transactions that aim at raising capital for investment activities could have negative knock-on effects on growth and jobs and the overall competitiveness of the economy. That is, why already the initial proposal foresaw not to tax such activities. As it is not ruled out that the issue of shares and units of UCITS and AIF also constitutes raising capital for investment (besides resembling part of a secondary market transaction when these shares and units had first been redeemed by investors in UCITS and AIF) it is recommended not to tax such issue. The effect (shortfall) on expected tax revenues of this recommendation is estimated at around EUR 4 bn. annually.

6.3 Sub-Option 2: Exempting certain actors

The initial proposal stipulates that the proposed directive shall apply to all financial institutions deemed to be established in the FTT jurisdiction involved in transactions in financial instruments, except the following entities: the European Financial Stability Facility, the European Stability Mechanism, Central Counter Parties, Central Securities Depositories and International Central Securities Depositories. Also, transactions with the European Central Bank and central banks of Member States should not be taxed.

The definition of what constitutes a financial institution was rather broad so as to avoid a potential loophole when taxing the trading in financial instruments. Thus, the definition of what means "financial institution" is rather broad, covering everything from credit institutions to "any other undertaking" carrying out financial transactions in case these latter constituted a significant part of their overall activity.

While the general aim of such a broad definition was shared by Member States, certain concerns were raised as regards the inclusion of some institutions either being public (such as the managers of public debt), pursuing activities in the interest of the general public (such as regional development banks), institutions whose activities "should be encouraged and not be taxed", such as pillar II and pillar III pension funds, or actors that are essential for an efficient functioning of financial markets such as the so-called "market makers".

6.3.1 Managers of public debt

One of the main aims of managers of public debt is to smoothen market developments for the secondary market of tradable public debt products such as government bonds and bills, as well as to steady the returns (on the secondary market) for investors in public debt products. Through this they also aim at minimizing the cost of issuing public debt.

Taxing such actors and their activities could make their business model less efficient while at the same time contributing to none of the primary objectives of developing a common system of FTT (no contribution of the financial sector, "zero-sum game" for the public budget, no discouragement of socially useless or highly leveraged activities) for as long as the managers of public debt are not massively active on markets with highly leveraged derivatives (on public debt).

- Managers of public debt of Member States of the FTT jurisdiction should be excluded from the scope of the directive. However, this shall not preclude the taxability of their counterparties. Such an exemption is neither expected to have negative impacts on public revenues nor is it expected to create additional tax-circumvention options.

6.3.2 Regional development banks

The main task of regional development banks it to raise capital on financial markets and to lend it on to the private sector or to finance public investment, e.g. in infrastructure. Trading in financial instruments does not belong to the business models of such banks, while some risk hedging might nevertheless be required.

The initial proposal does not foresee exempting from the scope of the FTT the activities of regional development banks. This was seen by some as taxing activities that should instead be supported. It is expected that only few transactions to be taxed would be those risk-hedging operations that are linked to the potential exposure to currency, interest rate and default risks.

On the other hand, exempting certain regional development banks might raise the issue of also totally or partially exempting other actors that also provide financing for private or public investment projects, including banks, AIF, insurance companies or pension funds. Exempting the one but taxing the others would challenge the fiscal neutrality of the FTT. Partly or fully exempting both would significantly narrow the tax base, especially as it would be difficult to define the fine line between financial transactions that are needed to hedge risks linked to the financing of such projects and those transactions that are not linked to the financing of such projects.

- It should be avoided to exempt regional development banks from the scope of the directive.

6.3.3 Market makers, broker-dealers, proprietary traders ("internalisers")

Taxing professional dealers such as market makers, brokers and proprietary traders could – at least at first glance – have two unintended effects: it could hamper the effectiveness of the functioning of financial markets (as it might trigger a reduction in liquidity and, thus, increase spreads and volatility), and it could generate a cascading effect in the value chain of a single transaction on substance, in case more than one financial institution was involved on each side of a transaction. On the other hand, taxing such activities could roll back business models that "internalise" spreads and, thus, only redistribute rents to the financial sector at the expense of the non-financial economy. Also, exempting them would have significant negative impacts on the tax yield.

To cater for the risk of a cascading effect within a transaction chain the initial proposal foresees to only tax one financial institution on each leg of a transaction (the last in the chain)

for as long as the other financial institutions were acting in the name or for the account of this last financial institution (the "disclosed client" provision).[50] An alternative to this disclosed client provision would have been to exempt market makers and broker-dealers from the scope of the tax in first place. However, this would then not only have put out of scope those trades between financial institutions that, after all, are a rent-seeking complement to intermediation (so-called "internalisation-of-spreads" transactions), but also those that are genuine trades between financial institutions. This, in turn, could have significant negative revenue implications as well and jeopardize the objective of ensuring a fair and substantial contribution from the financial sector for covering the cost of the crisis.

The potential impact of taxing market makers and broker-dealers on the efficiency of financial markets looks at first glance as being a real concern in case "high liquidity" and "minimal spreads" were ends in themselves and not means to an end. However, none of them is an end in itself but a means so as to minimize volatility and match marginal supply and demand at an equilibrium price.

Also, one would have to analyse to what extent additional liquidity (as e.g. provided by high frequency traders) really triggers liquid markets when there is a risk of illiquidity and whether minimizing spreads between ask and bid prices between different actors is not replaced by injecting spreads between the ask and bid price by the "market makers" and proprietary traders themselves.

Since the emergence of the global financial crisis in 2008, mainly hitting OECD economies having had the most sophisticated financial markets, the traditional paradigm of "the more the better" as regards liquidity and financial intermediation has been challenged. This also holds for the role of broker-dealers, market makers, propriety traders, high frequency traders and so-called "modern" investment banking activities (as opposed to "traditional" investment banking activities that tried to facilitate the raising of capital, restructuring of companies or mergers and acquisitions) in general.

This review eventually led to a paradigm shift triggering off a plethora of new financial market regulations trying to:

- better control what is going on in the shadow-banking sector;
- limit high-frequency and proprietary trading;
- deleverage derivatives markets and
- limit the turnover in products that are considered carrying a lot of risk or not contributing to the efficient functioning of financial markets but constituting mainly rent-seeking business models in favour of financial-market actors themselves.

Taxing the financial market transactions of such actors would, thus, complement and support financial market regulation, while not taxing them would forego this positive effect while at the same time violating the fiscal neutrality of the tax aimed at, as it would privilege these actors over all the other actors. Also, not taxing the transactions of market makers etc. would significantly reduce the tax base (with at least 50% in the case of transactions in securities).

- ➢ The transactions of brokers trading in their own name, and of market makers and

[50] Article 9.2 of the initial proposal (Article 10.2 of the new proposal) reads: "Where a financial institution acts in the name or for the account of another financial institution only that other financial institution shall be liable to pay FTT".

proprietary traders should be taxed.

6.3.4 Pillar II and pillar III pension funds

The reference to pension funds in the context of the proposal for a directive for a common system of FTT is to Institutions for occupational retirement provision (IORPs) regulated by the Directive 2003/41/EC (see Article 2.1(7) (f) of the initial Commission proposal). The quoted article also covers their specialised managers, especially for the case in which these institutions – which are usually the funds themselves – are not legal persons. Such institutions are private and are completely separate from the public (government-managed) schemes (under public law). So, in this context this paper will actually discuss only the so-called "pillar II" and "pillar III" pension systems.[51]

The relative importance of (funded) pension funds is very different across the European Union. It is the highest in the Netherlands (135% of its GDP or around EUR 850 bn. in 2010) followed by Finland (82% of the Finnish GDP)[52]. In Denmark and Ireland it corresponds to around 50% of GDP, while in countries like Germany, Austria and Italy it reaches around 5% of GDP. In some of EU10 Member States, such as Poland or Hungary, these pension funds have accumulated assets corresponding to around 15% of GDP.

The impact of an FTT on pension funds will depend on both the asset allocation (portfolio) and on the investment strategy (more frequent trading vs. less frequent trading, for example). If one looks at the asset allocation in selected pension funds, **not all these assets represent taxable financial instruments as defined in the proposal**, neither do all the transactions. As an illustration, cash and deposits and other assets (including derivatives, but also investment in real estate and others) make up for 22% (or almost EUR 190 bn.) in the Netherlands (over 4% in cash and deposits) and 34% in Bulgaria (over 28% in cash and deposits).

One could now argue that the introduction of an FTT would affect (private) pension funds involved in more frequent trading much more than those that trade less frequently in financial instruments, i.e. those funds pursuing a "buy and hold" strategy would be much less affected than those following an "active" strategy with significant and frequent turning over of assets. This difference is illustrated in the below box.

"Buy and hold" versus "active management" strategies

Example 1:

A Dutch pension fund has invested its assets of EUR 10 bn. the following way: 10% in shares, 10% in real-estate funds, 70% in bills and bonds, and 10% in other (such as cash or deposits or real estate). The Fund follows a passive "buy and hold" strategy, i.e. it shadows the relevant indices for shares, it purchases bills and bonds when they are issued and holds them until maturity. Pay-outs (to pensioners) and pay-ins (from contributors) are balanced. Due to changes in the composition of the stock-market indices, it has to turn over (buy and sell) on

[51] The model of the World Bank, intended as a blueprint for developing/transition countries, consists of (I) public pay-as-you-go (PAYG) pensions, (II) mandatory, privately managed pensions (occupational schemes), and (III) voluntary (private) individual accounts (without any link to the employment status).

[52] The Finnish system is one of the exceptions in the EU since it has a large funded part of what is normally defined as its pillar I pension fund, managed by private managers.

average 10% of its shares and real-estate funds each year. None of the new purchases are purchases on primary markets.

- Transactions in 80% (primary markets for bills and bonds, cash and deposit and other such as real estate) are out of scope of the FTT directive. The turning over of the shares and real-estate funds carries Dutch FTT.
- The pension fund has to pay EUR 400.000 Dutch FTT annually for the turning over of its shares in case the Netherlands applied the minimum tax rates. This corresponds to 0.004% of its assets.
- If these assets represented 20 years of savings / asset accumulation the annual figure of 0.004% of total assets translated into 0.08% of annual savings, i.e. a pensioner who has invested EUR 100/month would receive returns (after FTT) as if he had invested only EUR 99.92/month in case the fund managers passed these costs on fully to the pensioners and not to the borrowers of capital.

Example 2:

Same asset structure etc. as in the previous case, but this time the pension fund follows an "active" strategy, and turns over all its assets except cash and deposits and other (such as real estate), i.e. 90% twice a year. It does not intervene on primary markets for bonds, bills and shares. Also, as it is more exposed to market volatility, it is assumed to hedge 90% of all its assets four times a year against diverse risks.

- The turning over of assets carries Dutch FTT, so do the hedging operations;
- The pension fund has to pay EUR 36 mn. Dutch FTT annually for the turning over of its assets. Annual Dutch FTT for hedging 3.6 mn. This corresponds to 0.396% of its assets.
- If these assets represented 20 years of savings / asset accumulation the annual figure of 0.396% of total assets translated into 7.92 % of annual savings, i.e. a pensioner who has invested EUR 100/month would receive returns (after FTT) as if he had invested only EUR 92.08/month in case the fund managers passed these costs on fully to the pensioners and not to the borrowers of capital.

As these active funds would also have to cover the market risk of falling bond prices on a permanent basis (mark to market), as they would like to maintain the option to sell these bonds before maturity their derivatives activities might also be more important by several orders of magnitude. This impact could possibly be partly offset due to the potentially positive effect a FTT would have on volatility of bond prices which would benefit the longer term investment strategy of pension funds (because of higher predictability). Evidence in the economic literature on this effect on volatility is however mixed.

Also, the investment strategy with respect to the portfolio structure could have an impact on the effects of the FTT on pension funds, as e.g. investing in government bonds and bills on primary markets would not be a taxable transaction, while buying and selling shares on secondary markets or investing in derivatives such as structured products would be taxable events.

Not taxing the issue of shares and units in UCITS and AIF together with not taxing primary markets for securities already covers a significant part of the financial market transactions typically undertaken by pillar II and pillar III pension funds, notably by the more "passive" ones. This, in combination with the assumed substantial fall in the turnover of derivatives

contracts should effectively ring-fence these pension funds from the direct effects of the FTT.[53]

The same mechanisms should be at work as regards the indirect effects, i.e. pension funds investing in financial institutions and funds (of funds) who themselves are then active on financial markets. The FTT would favour investments in more passive investment vehicles. Also, due to reduced churning and hedging by these vehicles themselves the latter's substantial management fees would have a potential for being reduced. The partial crowding out of "spread internalisers" or high frequency traders should also help both pension funds themselves and the vehicles in which they invest to get better deals on financial markets.

In sum, the impact of the common system of FTT in EU11+ can be expected to have a rather limited impact on pillar II and pillar III pension funds and their beneficiaries. Also, asking for an exemption (or special treatment) under the FTT directive for pension funds would undermine the level-playing field between various products available for savings and retirement. Despite the specifics of pension funds, there are equivalent products available on the markets, such as various types of bonds, collective investment funds and life insurance contracts (unit-linked insurance plans). Moreover, pension funds (both public and private) enjoy a favourable tax treatment in numerous Member States.

- ➢ Pillar II and pillar III pension funds should not be excluded from the scope of the directive.

6.3.5 Conclusion

Exempting certain actors, namely professional dealers, brokers or market makers from the scope of the common system of FTT would have significant negative repercussions for the achievement of the key objectives of the initiative. It would notably:

- jeopardize achieving the aimed-at tax neutrality of the initiative as it would trigger distortions between different actors (and products) in the Single Market,
- jeopardize the achievement of the goal of receiving a fair and substantial contribution from the financial sector to covering the cost of the recent crises. This would also jeopardize achieving the goal of consolidating public budgets or to generate revenues for growth-enhancing public investment. After all, more than half of all financial market transactions are carried out by those actors.
- jeopardize the achievement of the goal to contribute to a better functioning of financial markets. This holds especially when one decided not to tax all these financial institutions.

On the other hand, excluding the managers of public debt should hardly have any negative impact on the achievement of the key policy objectives. The same, however, does not hold for

[53] According to information provided by representatives of the Dutch pension fund industry, it appears that around 50% of a tax bill of EUR 3 bn. annually would stem from the tax on repurchase agreements, 37% from taxing its investment in equities and bonds and about 13% from the tax on derivatives. Repurchase agreements could be turned into tax-free borrowing and lending operations combined with risk-offsetting derivatives contracts. Also, pension funds are, as institutional investors, key players on tax-free primary markets for equities and bonds and collective investment funds. It is also assumed that the turnover of derivatives markets will decline by about 75%.

exempting other actors, such as development banks or pillar II and pillar III pension funds, as these are in competition with other actors often providing similar services.

6.4 Sub-Option 3: Changing the provisions on the residence principle

When trying to tax financial transactions, one has to decide what should be the determining factor triggering a taxable event: Should it be the place of transaction that counts? Should it be the actor (and where it is established) that counts? Should it be the product (where it has been issued) that counts? Or should it be a combination of two or all of these parameters?

Traditionally, countries have opted either for the first criterion (it is relevant where a transaction takes place, and not who is trading or what is traded) or the third criterion (it is relevant what is traded and not who is trading or where the trade takes place). The other parameters and the key parameter itself were then simply used to define exemptions, e.g. the UK Stamp Duty is based on the issuance principle, i.e. the tax is a tax on the purchase of financial instruments issued in the UK, but not all of them (only shares and not e.g. government bonds or derivatives) and the tax does not have to be paid by each buyer (e.g. brokers and market makers are exempted).

6.4.1 The features and effects of the original proposal

The Commission in its initial proposal for an FTT has opted for taxing transactions on condition that at least one party to the transaction is established in a Member State and that a financial institution established in the territory of a Member State is party to the transaction or is acting in the name of a party to the transaction. The main reason for this approach was that one key aim of the FTT is to design the tax that guarantees tax neutrality while at the same time enabling Member States to receive a fair and substantial contribution from the financial sector for covering the cost of the financial market and subsequent economic crisis, and that this would only be possible when one taxes all financial products, including derivative agreements. However, as the majority of these latter (over-the-counter derivatives) are typically not issued somewhere precisely (except for the exchange-traded derivatives) and as they can be concluded wherever in the world, solely relying on the place of transaction principle or solely on the issuance principle would not have allowed taxing such products.

However, what looks in the initial Commission proposal at first glance as applying the residence principle only (EU party and EU financial institution) is at second glance, i.e. when also taking the provisions of Article 3 of the initial proposal into account, a combination of the residence and of the place of transaction principle. Indeed, Article 3.1 stipulates: "*For the purpose of this directive, a financial institution shall be deemed to be established in the territory of a Member State where … it has been authorised by the authorities of that Member State to act as such, in respect of transactions covered by that authorisation*". However, if one wants to trade on European trading platforms and interact with European trading platforms one needs an authorisation for doing so. Thus, it was also aimed at that all relevant transactions on EU territory would have been taxable events.

In consequence, the broad-based residence principle proposed in September 2011 already casted a very wide net to catch financial transactions. At the end of the day, only those transactions that did not serve EU clients or that did not take place in the EU at all and, thus, had no link whatsoever between the economic substance of the transaction and the territory of

any Member State would not be taxed. Applying this design to EU11+ instead of EU27 would – at first glance – not weaken the effectiveness of this approach.[54]

6.4.2 Adding elements of the issuance principle

Some ideas that aimed at strengthening these provisions on the establishment were discussed in both the Council and the European Parliament; the basic idea was to also cover those transactions where products issued in a (participating) Member State would be traded by non-EU(11+) parties.[55] Thus, it was proposed to not only check "who is interacting with whom?" but also "what is traded?" independent of whether an EU(11+) party is involved in the transaction or not. This proposal got its inspiration from the application of securities transaction taxes around the world, including the UK Stamp duty and Stamp Duty Reserve Tax (SDRT).[56]

This addition concerns essentially shares, bonds and equivalent securities[57], money-market instruments, structured products, units and shares in collective investment undertakings and derivatives traded on organised trade venues or platforms. In these cases, the transaction has a sufficient connection with the participating Member State in which these instruments are considered to have been issued (i.e. where the reference entity/company is residing). The persons involved in trade in these instruments will be deemed to be established in that Member State, and the financial institution(s) concerned will have to pay FTT in that Member State.

Adding such an element to the provisions already tabled could assist participating Member States in fighting evasion and relocation and catch another significant portion (about 10%) of financial transactions in shares issued by EU11 entities and of transactions in debt securities issued by EU11 entities[58] (not captured by using the residence principle)., which would yield as revenues EUR 0.39 bn. from taxing shares and 0.83 bn. from taxing bonds and bills.[59]

However, while such a provision for the trading in securities should not raise any legal concerns as regards extraterritoriality (after all, this principle is already well-established international tax practice), this might not hold for applying this principle to derivatives, i.e. financial instruments that were derived from a security issued in one of the participating Member States. Complementing the proposed residence principle by elements of the issuance principle could help to further discouraging relocation, as indicated in the proposal for a

[54] See, however, also section 6.4.4.

[55] See, notably, the opinion of the European Parliament of 23 May 2012 on this.

[56] See Annexes 1 and 2 for more details on this issue.

[57] Depositary receipts or similar securities issued with the essential purpose of avoiding tax on transactions in the underlying security issued in a participating Member State (i.e. if a tax benefit would otherwise arise) should be considered issued in that participating Member State and should also fall within the scope of the tax.

[58] IMF (2012) – Coordinated Portfolio Investment Survey (CPIS) and own calculations.

[59] Specific assumptions were made: transactions of the rest of the world minus international organisations minus EU27 are carried out 30% outside the reach of the residence principle, while transactions of the rest of the EU (EU27 minus EU11) are carried out 20% outside the reach of the residence principle. As the CPIS reports positions, an annual average turnover rate of 110% for shares and for bonds was assumed (a rather conservative hypothesis; see European Commission (2008) - The European Financial Integration Report/EFIR, p.33). It was also assumed that only 85% of these transactions are carried out with at least one financial institution involved.

Council decision authorising enhanced cooperation in the area of FTT and in the letters of request from the eleven Member States, and to supplement to a small extent the tax revenues.

6.4.3 Changing the order of conditions

The order of conditions defining the "establishment" of a financial institution or a non-financial institution party to a transaction in a financial instrument also determines the place and Member State of taxation. The proposed order followed the logic that the first right to tax should be given to the place of establishment of the headquarter of a financial institution, as – after all – it had typically been the Member State of the headquarter of a group that had been forced to bail out financial institutions having entered and having got problems in the troubled waters of the financial market and the subsequent economic crisis.

However, some Member States (namely some of the new Member States and some smaller peripheral Member States) claimed that the order of conditions would disfavour those countries in which the financial sector is dominated by branches of banks of other EU27/EU11+ Member States. Thus, these branches would have to pay the tax, but the revenue would accrue to the Member State of principal establishment where the respective headquarters were deemed to be located.

Other Member States would have liked to see that the elements of the issuance principle should get priority over the other criteria so that the tax revenues from trading in products issued in a Member State would accrue to those countries in which the traded products (such as enterprise shares or government bonds) had actually been issued. Such a proposal might benefit those countries that are more heavily indebted or that have a strong share-holding culture. However, under such an approach, due account would have to be taken of the evolving legislative and regulatory framework that will in future also allow a more flexible approach towards the place and country of issuance.

Parties located in non-participating Member States and in third countries would actually benefit from the same treatment according to the rules on establishment laid down in the proposal for a Directive.

- All three approaches have their pros and cons. However, as the bailing out of financial institutions had primarily been undertaken by those Member States where the headquarters were located, there might be certain logic in maintaining the order of criteria as proposed by the Commission.

6.4.4 The effects of enhanced cooperation on the effectiveness of the proposed residence principle

Under the initial proposal, if implemented at the level of the entire European Union, all relevant transactions carried out on the territory of a Member State would have been a taxable event, as both EU and non-EU financial institutions typically need an authorisation for such transactions undertaken in the framework of their specific activity. The difference between financial institutions from the EU[60] and those from the rest of the world was, however, that

[60] Three members of the European Economic Area (EEA) are also part of the Internal Market through the Agreement on the European Economic Area, effective as of 1994, namely Iceland, Lichtenstein and Norway (members of the European Free Trade Association/EFTA, next to Switzerland) – hereafter referred to as EFTA3.

EU (and EFTA3) financial institutions typically got the authorisation in a single Member State to undertake the transaction wherever in the EEA (the so-called "passport"), while financial institutions from the rest of the world needed such an authorisation for each Member State in which they wanted to trade.

Under enhanced cooperation there are now three groups of actors: (i) non-EEA financial institutions trading in the FTT jurisdiction and needing a specific authorisation there, (ii) financial institutions from the FTT jurisdiction and having received their authorisation there, and (iii) financial institutions from non-participating Member States and from EFTA3 countries having received the authorisation in their home country and also being allowed to carry on their specific activities and trade in the FTT jurisdiction. Under an FTT for EU27 this third group would not have existed, thus, not caused differentiated treatment of the different actors as all groups would have had to pay the tax.

Under and FTT for EU11+, however, and under unchanged provisions, the third group, i.e. financial institutions from non-participating Member States and from EFTA3 countries would escape from having to pay the tax in case they were interacting within the FTT jurisdiction with another party not deemed to be established there. Thus, one would have to add elements of the place-of-transaction principle if one wanted to fix this new problem of non-taxation despite the fact that the transaction took place in the FTT jurisdiction. Also, and so as to avoid a discrimination of regulated trading venues (where authorisation is typically needed) and non-regulated trading venues and over-the-counter transactions, this place-of-transaction features should also be extended to transactions carried out for these latter venues and transactions.

- The initial principle should be maintained and complemented by elements of the issuance principle for securities and elements of the place of transaction principle. The ranking of the conditions triggering taxation and the place of taxation could be left to Member States to agree upon themselves. This latter issue has mainly implications for the regional power to tax.

Also, concerns have been raised as some important financial centres, notably London, Amsterdam, Luxemburg and Dublin, are located in the EU but not in the envisaged FTT jurisdiction. On the one side, Member States hosting such financial centres fear that as a consequence of the establishment of a common system of FTT in EU11+ activities in these centres previously having not been taxed would in future be taxed, thus, making these financial centres less attractive. On the other side, participating Member States fear that financial institutions established in the FTT jurisdiction might either relocate their activities to these financial centres, thus, triggering negative repercussions for their own financial industry, or they might turn their branches already active in these financial centres into legally independent subsidiaries, both of this with the aim of minimizing the tax burden.

The first kind of concerns would in principle be unfounded in case the proposed broadly-defined residence principle was properly implemented, as in such a regime all financial centres would be affected in the same way, i.e. transactions involving financial institutions deemed to be established in the FTT jurisdiction would be taxable, independent of whether they were carried out in Frankfurt, London, New York or Zurich. On the other hand, transactions not involving financial institutions deemed to be established in the FTT jurisdiction would not be taxable under enhanced cooperation, neither in London nor in New York or Zurich.

Of some relevance – at least at first glance - seem to be the concerns that financial institutions of Member States of the FTT jurisdictions might want to relocate their headquarters to non-participating Member States or to turn their branches in non-participating Member States into legally independent subsidiaries in the hope that these subsidiaries would not be deemed to be established in a Member State of the FTT jurisdiction.

This relocation of the seat or the "subsidiarisation" of branches would, of course, not help avoiding having to pay the tax for as long as the counterparty or the client on behalf of whom they are acting was deemed to be established in the FTT jurisdiction (or as long as the financial institution would trade in instruments issued by EU11+ entities). However, such a relocation of the headquarter (or a "subsidiarisation" of branches) could be seen as a way to circumvent having to pay the tax for all transactions for which the counter party or the client on behalf of which they are acting was also not deemed to be established in the FTT jurisdiction, i.e. transactions exclusively with or on behalf of clients from the non-FTT jurisdictions (on instruments issued for entities from outside the enhanced cooperation zone).

6.4.5 Conclusion

Adding elements of the issuance principle would strengthen the anti-relocation features of the proposed residence principle and make additional transactions taxable. In sum, it would positively contribute to achieving the key objectives of the proposal. So as to cater for the fact that the common system will first only be implemented for a subgroup of Member States instead of the entire European Union and in order to maintain the integrity of residence principle as initially proposed.

The changes proposed in this section should make sure that achieving the initial objectives will not be challenged. Changing the order of criteria triggering the taxable event would mainly have an impact on the regional distribution of tax revenues, mainly at the expense of those Member States that host the headquarters of important financial institutions and in favour of those Member States that host branches of financial institutions.

6.5 Sub-Option 4: Phasing in of the common system

From an economic point of view it would be best to implement all the proposed common system of FTT at the EU11+ level at the same time, as a "big bang", as temporarily exempting certain actors (such as pension funds), products (such as the trading in government bonds or parts or the entire derivatives market) or markets (such as non-organised markets or over-the-counter transactions) would:

- Trigger massive substitution of taxed and untaxed activities, e.g. the trading in shares and bonds might be replaced by the developments of "contracts for difference" or "financial spread bets" in case derivatives markets were not covered;
- Entail substantial discrimination between products that were taxed (such as the trading in enterprise shares or bonds) as compared to those not taxed (e.g. trading in government bonds);
- Provide preferential treatment to certain actors (such as "market makers" or high-frequency traders) that introduce a spread of their own into markets, that inflate market volumes and potentially contribute to injecting additional risks and volatility in financial markets;
- Privilege non-taxed trading platforms or business models (such as over-the-counter activities) in case they were exempted;

- Jeopardize the proper functioning of the single market as a result of all these inefficiencies;
- Substantially erode the revenue basis and, thus, make it impossible to achieve one of the core objectives of the whole initiative, i.e. making sure that the financial sector makes a fair and substantial contribution to financing the costs of the crisis.

However, such a "big bang" might be too difficult to implement in the near future also because little or no experience exists in the EU or world-wide with taxing the most mobile products and actors in the context of a broad-based FTT. Thus, a step-by-step approach might be the appropriate compromise by starting narrowly, gaining experience and then enlarging the scope of the initiative.

In any case, in such a step-by-step approach the envisaged "end-game" (all markets, all products and all actors) would have to be established in the directive as it would otherwise no longer be based on the scope and objectives of the initial proposal.

6.6 The macro-economic effects of an FTT under enhanced cooperation

As explained in the Impact Assessment accompanying the initial proposal, the use of Dynamic Stochastic Equilibrium (DSGE) models is a standard procedure of estimating the macroeconomic effects of policy changes.[61]

Their advantage over sector-specific Partial Equilibrium Models is that they fully take into account spill-over effects to other sectors as well as second-round effects triggered by a policy change, including the effects of the recycling into the economy of higher tax revenues. One possible disadvantage is that they typically have a less detailed sectoral breakdown of the economy than partial equilibrium models.

In order to assess the macroeconomic impacts of taxes on financial transactions specifically, Commission services have developed a new DSGE model. The version of the model used for the Impact Assessment was built on the assumption (amongst others) that all investment is financed with the help of issuing new shares, and that a fall in the price of shares works as a financing constraint for new investment and will hence trigger a decline in overall investment.

The model is a two-period (comparing two equilibriums) and closed-economy model. It includes hypotheses in terms of relocation and market reaction and, in the absence of specific information on the speed of the process; the assumption is made that the new "steady state" would be reached after 40 years[62].

The model could at that time not take into account the full concrete design of the tax as defined in the proposal. It was also based on the strong assumption that all new investment had to be exclusively financed with the help of issuing new shares that are traded and subject to the tax. As a result, the mitigating effects included in the proposal remained outside the model simulations and were taken into consideration ex post. This held namely for:

[61] SEC(2011) 1102.

[62] In multi-period DSGE models, it typically takes several decades until the new equilibrium is reached. So as to remain consistent with other long-term modelling approaches (such as energy, transport and climate roadmaps) or long-term scenarios (such as demographic scenarios), the year 2050 was chosen.

- the exclusion of primary markets from taxation;
- the exclusion of transactions that do not involve financial institutions or only non-EU parties;
- the ring-fencing of financial sources for investment that do not rely on securities.

Since September 2011, the model has been further developed. In particular, the assumption that all investment has to be financed with the help of issuing new shares has been changed to take into account the fact that in the real world companies also have access to alternative sources of finance that are not subject to the tax. This holds notably for the bulk of European enterprises (more than 95% if taken by number) not listed on stock exchanges and neither issuing shares nor other securities.

The additional model specifications[63] allow for the assumption that only a part of the sources of financing are affected by the tax on financial transactions. Indeed, securities-based financing is only partly affected by applying the tax (primary markets are excluded) and - more importantly - other forms of financing (such as borrowing from banks or the raising of capital through venture capital funds) are not taxed. Depending on the source and method applied[64], these alternative and untaxed finance sources represent between 60 and 80% of all financing of investment. In the central scenario (assumed to be a conservative one), it is assumed that these alternative and untaxed finance sources represent 70%.

Under these assumptions, the estimation of the possible deviation of GDP was established at -0.28%, as the tax is simulated to increase the cost of capital by about 7 basis points in this scenario. As a consequence, in such a scenario, instead of being 81.4% above today's level, the European GDP in around 2050 would have risen by 81.1% above today's level.

Also, and as was highlighted in the Impact Assessment as well, these model simulations assume the recycling of revenues generated by the FTT back into the economy with the help of lump-sum transfers to private households, so as to keep the debt-to-GDP ratio constant and so as to allow for isolating the "distortionary" impact of the tax from other distortions. Through this, the model paints a modest negative impact of the tax on economic efficiency and, thus, on GDP.

An alternative scenario which lowers e.g. labour or corporate tax rates instead of lump-sum taxes to rebate FTT revenues would lead to a more favourable picture for overall economic efficiency and, thus, economic growth.[65] The same held if the tax revenues collected were spent – be it at the European or be it at the national level - on growth-enhancing public

[63] For more details on the model specifications ECFIN(2012) – Securities Transaction Taxes: Macroeconomic Implications in a General-Equilibrium Model (economic paper by Rafal Raciborski, Julia Lendvai, Lukas Vogel).

[64] The sources of financing of companies are generally assumed to be new equity (10%), retained earnings (55%) and debt (35%). The share of debt securities in total debt of non-financial corporations is estimated at about 15% (or about 5% of total financing). Hence, assuming bank debt and retained earnings are ring-fenced, the share of corporate financing that would be directly affected by the FTT is about 15% of the total. See for more details e.g. SEC(2011)1102, p 52 (method: Devereux-Griffith methodology, sources: ECB (2010), BIS quarterly Review June 2011). Assuming that other sources of financing (such as the retained earnings of listed companies) were also affected by the tax, this ratio could rise to about 20 to 40%.

[65] For more details see ECFIN(2012) – Securities Transaction Taxes: Macroeconomic Implications in a General-Equilibrium Model (economic paper by Rafal Raciborski, Julia Lendvai, Lukas Vogel).

investment. Here, model simulations show a positive impact of such spending (as compared to providing lump-sum transfers to private households) in the order of magnitude of 0.2% to 0.4% of GDP.[66] Thus, in the case FTT tax revenues are used for productive public investment, the net effect of introducing FTT on the long run level of GDP (i.e. the deviation from a scenario without the tax of the level of GDP after about 40 years) would be expected to be in the range between -0.1 and 0.1 percentage points.

For some countries, notably those with an unsustainable debt-to-GDP ratio, using the revenues from the FTT for debt reduction might be economically most promising, as this would have direct and very positive knock-on effects on business and consumer confidence in these countries and on bringing down interest rates and interest burdens for both the public sector and the real economy.

Macro-economic effects of the tax could also be definitely positive if one took into account fairness and redistribution effects, which can typically not be modelled. Indeed, the objective that the tax should ensure that the financial sector makes a fair and substantial contribution to covering the cost of the crisis is not only based on efficiency grounds, i.e. those that benefit from the provision of a public good (rescue operations) should also be those that should pay for it (principle of fiscal equivalence). This objective is also linked to the aim of closing a fairness gap. For as long as this gap was perceived of not having been (sufficiently) closed and, thus, others would continue having to shoulder the burden, there remains the underlying risk of social tensions, general strikes and political instability. Each working day lost (e.g. due to a general strike) implies a substantial cost for the economy which, depending on the country, can be estimated between 0.05 to 0.2% of its GDP.

The fact that the FTT is now supposed to be introduced at the level of EU11+ instead of EU27 does not change the picture with respect to the economics and the growth and jobs performance in non-participating or participating Member States. The reason for this is that the underlying mechanisms of macroeconomic relevance (a modest increase in the cost of capital on the one side and additional public revenues on the other) net themselves largely out.

Thus, there is no measurable negative effect identified for growth and jobs in the participating Member States, and a positive effect on jobs and growth in participating Member States is not unlikely. As regards other regions in the world, which would - under enhanced cooperation - also comprise non-participating Member States, they should neither suffer from a negative nor should one expect a positive effect. The increase in the cost of capital in non-participating Member States of developing a common system of FTT in EU11+ should at most be a fraction of the (already rather tiny) assumed increase in the cost of capital in EU11+. On the other hand, however, non-participating Member States neither have additional tax revenues at their disposal which they could recycle in a growth-enhancing way.

When engaging in transactions in financial instruments with the financial institutions and the client base in the FTT jurisdiction, transaction costs (including taxes) could increase somewhat as a result of the introduction of an FTT for the financial institutions of both non-participating Member States and the rest of the world. This might trigger some changes in business models and other market reactions, such as more intermediation instead of "spread internalisation", deflating excessive market volumes, reducing the share of high-frequency

[66] European Commission, DG ECFIN (2012): Quarterly Review of the Euro Area.

trading in total turnovers and the frequency of risk hedging operations, or changing to other untaxed activities.

In case financial institutions of non-participating Member States were not able to pass this tax on to their client base or counter parties from the FTT jurisdiction this might eventually trigger some compression of rents earned in the past with such transactions, although the expected rates of return of the individual transactions should still remain positive. Also, it could serve as an incentive to improve the efficiency of financial services, e.g. by reducing transaction costs.

None of this should have negative competitive repercussions on the financial institutions of non-participating Member States or of non-EU countries. After all, the same rules would apply to every actor, independent of its country of establishment for as long as it interacted with an EU11+ client (or was involved in a transaction on a financial instrument issued in the FTT jurisdiction or taking place on the territory of a Member State of the FTT jurisdiction).

Also, and due to its size and attractiveness, no negative effect should be expected on the financial capacity of the EU11+ and the EU27 market. While the economy of EU27 constitutes about one quarter of global economic activity, the economy of EU11+ constitutes after all about two thirds of this economy and more than 90% of the economy of the Euro zone. This would make it look rather unattractive from a business perspective not to serve and interact with this market. Also, as the entire EU but also EU11+ can be characterised as large and open economies, capital flows should continue to go in both directions, and the capital and current account balances will continue to be determined by underlying competitiveness performances and not by the levying of an FTT on the trading in financial instruments.

6.7 Other (micro-)economic effects

Experience with other taxes on financial transactions invites for the conclusion that the costs of administering the common system of FTT in EU11+ can be expected to be very subdued both for tax administrations and taxable persons, once the IT systems are up and running. The cost of administering e.g. the UK Stamp Duty is reported to be about 0.1% of the revenue collected.[67] This compares very favourably with the collection of other major taxes, such as VAT or income taxes. The reason for this is that almost all transactions are carried out electronically; information is collected and processed by clearing houses and regulatory authorities, and must be kept by financial institutions for some years, thus, facilitating tax audits and enforcement.[68] If one took the UK Stamp Duty collection cost as also being representative for the EU11+ FTT, and even when correcting for the fact that the number of trading platforms and other actors will be higher in EU11+ than in the UK, the costs of administering the common system of FTT in EU11+ should be in the order of magnitude of about EUR 50 to 150 million annually in case it was implemented centrally. However, in case of un-coordinated decentralised and national solutions the costs might be significantly higher.

Also, experience in countries having introduced such a system shows that the setting-up cost of the relevant IT systems, especially when trading platforms, central counter parties and clearing houses are involved, remain very limited.

[67] IMF/Brondolo (2011).

[68] See chapter 8 for more details.

Finally, the administrative burden in its more narrow sense, i.e. the provision of information by the regulated industry (financial sector) to public administrations (tax authorities) can be assumed to be very negligible, as all relevant information will have to be transmitted to regulatory authorities already in different other contexts (notably in the context of new financial market regulation that aimed at increasing transparency on the relevant markets).

Financial operators not only from the participating Member States but also from outside will also benefit from the simplification inherent to the harmonised regime applicable by all participating Member States, as opposed to a scenario of diverging non-harmonised FTT regimes.

Concerns have been raised that a common system of FTT in Europe might undermine the competitiveness position of the European financial sector and its institutions and might, thus, trigger massive layoffs, notably in financial centres specialised on the new form of investment banking. Already the initial impact assessment has shown that these concerns are largely unfounded, as the transactions potentially most negatively affected (such as automated high-frequency trading) are already not very labour intensive.

Moreover, the potential labour market effect in financial centres also depends on the business strategies of the institutions affected, i.e. the effects of the tax – if not passed on to clients – could be absorbed by reduced (but still positive) margins, reductions in salaries (notably so-called bonus payments) or other measures changing business models. In the start-up phase, jobs might even be created that aim at optimizing IT systems and developing new business models that step in for reduced turnovers in taxed market segments.

On balance, however, no negative employment effects are to be expected for the entire economy of the FTT jurisdiction, as the recycling of FTT revenues will trigger demand in sectors outside the financial services industry.

As regards the (micro-economic and competitiveness) effects of an FTT on individual sectors of the non-financial economy such as the energy sector, manufacturing industry, the construction sector, services or small and medium-sized enterprises (SMEs) in general different impacts are to be expected, depending on the sector analysed and on the business model characterising a sector as regards activities on financial markets:

- For some sectors, such as the energy sector, the investment goods industry or trade-intensive sectors with significant trade activities outside the domestic currency area, hedging price and exchange-rate risks could become somewhat (about 0.01% of the price of the underlying) more expensive as a consequence of direct effects of an FTT of 0.01% on derivatives contracts. On the other hand, the positive indirect effects from squeezing out excessive intermediation or of "spread internalisation" should largely offset this direct effect;

- For those sectors and companies that finance their investment activities also with the help of issuing shares and enterprise bonds (on top of financing investment with the help of the cash-flow generated or with the help of traditional – and tax free - enterprise loans provided by the financial sector), the cost of capital might edge up as well due to higher transaction costs on the secondary markets for these securities. Model simulations hint at an increase by about 7 basis points. But also here, the positive indirect effects from squeezing out "excessive" financial intermediation or of "spread internalisation" should largely offset this direct effect;

- Finally, it is safe to assume that SMEs will not be negatively affected by the FTT, as all financial transactions typical for SMEs are out of scope of the common system of FTT. In case an SME intended to hedge itself certain price, interest rate or currency risks, it might be slightly affected. But here, as in the case of the other sectors, the negative and positive effects should largely offset each other.

Thus and on balance, the competitiveness of the non-financial sector should not be negatively affected by the common system of an FTT. Neither should the innovative or productivity performance of non-financial companies, be they large global players or be they SMEs, be negatively affected. On the contrary, as the relative attractiveness of investing in financial instruments will edge down as compared to investing in the real economy some of the capital presently locked in financial market activities might be re-channelled to finance additional investment in the real economy.

7. COMPARING THE DIFFERENT POLICY OPTIONS

The impact assessment having accompanied the initial proposal of September 2011 has clearly shown that in the absence of coordinated EU action, none of the objectives of taxing the financial sector would be met. In other words, solely relying on un-coordinated national action would lead to a plethora of different national systems to tax the financial sector, thus, undermining the proper functioning of the Single Market, triggering numerous incidences of double taxation and – more importantly – of double non-taxation despite the overarching aim of ensuring that the financial sector makes a fair and substantial contribution to financing the costs of the crisis. No tax neutrality amongst different products, market places and actors would materialise, and it would be easy for actors to design their transactions, especially the more mobile ones, so that no tax would be due. In consequence, the potential revenue stream would be rather small and tiny (potentially except for countries hosting important financial centres), and taxation would hardly contribute to strengthen the effectiveness of regulation to discourage activities that do not improve the functioning and stability of financial markets while at the same time inviting for myopic behaviour and rent seeking.

Against this benchmark and in the absence of a global solution, a common system of a Financial Transaction Tax (FTT) for EU27 as proposed by the Commission in September 2011 (option B) would perform very positively in all dimensions (see table below). It would have been able to avoid any kind of double taxation or double non-taxation within EU27, to design the tax in a way that it is neutral across all actors, all markets and all instruments. Thanks to its broad base and powerful anti-relocation, anti-evasion and anti-avoidance features a EU27 common system would have allowed to make sure that the financial sector makes a fair and substantial contribution to financing the costs of the crisis, while at the same time discouraging some of the activities that do not improve the functioning or stability of financial markets.

However, the option of establishing a common system of FTT for EU27 was not possible for political reasons and will not be possible to be achieved in the foreseeable future. Thus, 11 Member States representing about two thirds of the entire EU27 economy, have requested to be allowed to go ahead under enhanced cooperation (option C) and based on the objectives and scope of the initial Commission proposal. While not being as effective as the same policy implemented at the level of EU27 (it will not be possible to avoid all incidents of double taxation within the entire EU27 for as long as not all Member States will have joined the FTT jurisdiction, and also the anti-relocation / anti-evasion provisions, albeit still being very powerful, will be a little bit less effective than the same FTT under an EU27 regime) a common system of FTT at the level of EU11+ will constitute a major improvement as compared to the baseline scenario.

Under the Danish Presidency, several sub-options of the FTT had also been discussed in the six meetings of the Council Working Party. At that time these discussions took place under the assumption that the common system of FTT would be applied at the level of EU27 and not at a subset of Member States. However, the same discussions might pop up in the discussions at the subset of Member States as well. The different variants discussed could be clustered in the following four sub-options:

- permanently exempting from the scope of the directive certain financial instruments, such as the issue of shares in UCITS or AIF or repo agreements (sub-option C.1);

- permanently exempting from the scope of the directive certain actors, such as the managers of public debt, regional development banks, the activities of pillar II and pillar III pension funds, so-called " internalisers" such as market makers, broker-dealers and proprietary traders (sub-option C.2);

- strengthening the anti-relocation features of the common system by complementing the residence principle with elements of the issuance principle and changing the regional tax incidence by altering the order of criteria also determining the assignment of the power to tax of the different Member States (sub-option C.3), and

- introducing the common system only gradually, i.e. temporarily exempting certain actors, markets and products and broadening the tax base only successively (sub-option C.4). So, it might take several years until the scope and objectives as proposed by the Commission in its initial proposal will have been implemented.

The analysis of the impacts of different policy options carried out in chapter 6 has found that both, option C and the four sub-options analysed would still feature better than the baseline scenario of doing nothing on all dimensions (as indicated by the "+" symbols in the below table, except for the criterion "anti-evasion", as in such a case non-taxation of the most mobile tax bases might turn out to be the dominant pattern of national tax regimes. However, only the sub-option C.3 would feature as well or even better (with respect to its revenue-raising and anti-relocation characteristics) than the initial Commission proposal adjusted for EU11+ (option C).

However, the analysis of chapter 6 (namely sections 6.2 to 6.5) also invites for the conclusion that some of the more tailored measures in the sub-options C.1 to C.3 (the measures shaded in grey in the table) should be considered for adoption, while sub-option C.4 (phasing in of a fully-fledged FTT) would come with significant shortcomings as compared to the establishment in one go of a common system of FTT covering all products, all actors and all markets.

Thus, given the impossibility of establishing a common system of FTT at the level of EU27, and in the light of this analysis of policy options and impacts, the most promising policy might be to introduce the common system as proposed by the European Commission in September 2011, but at the subgroup of 11 Member States under enhanced cooperation, while adjusting and complementing it with the following elements of sub-options C.1, C.2 and C.3:

- exclude the issue of units and shares of UCITS and AIF from the scope of the directive so as not to run the risk of taxing the raising of capital;
- exclude the managers of public debt from the scope of the directive so as not to interfere with their activity of smoothing the market;
- add elements of the issuance principle, and complement the "authorisation" criterion so as to close a potential loophole under enhanced cooperation, thus, strengthen the anti-relocation features of the proposal.

It could be left to the outcome of negotiations amongst participating Member States to what extent they want to alter the order of criteria determining the Member State of establishment

as well as the regional tax incidence, especially when they agreed on what all of them could consider as being a fair revenue-sharing system.

Table 2: Comparing the different policy options*

	Single Market	Tax neutrality	Anti-relocation/ evasion	Potential additional revenue	Discouraging excessive risk taking, rent seeking, myopic behaviour
Baseline (no action)	**0**	**0**	**0**	**0**	**0**
Option C (FTT at EU11)	++	+++	++	+++	++
<u>*Sub-option C.1*</u> *(EU11, but permanently exempting instruments)*					
UCITS/AIF	++	++	+	++	++
Public debt	++	++	++	++	++
Repos	++	++	+	+++	++
Derivatives	++	0	0	+	0
<u>*Sub-option C.2*</u> *(EU11, but permanently exempting actors)*					
Managers of public debt	++	+++	++	+++	++
Development banks	+	++	+	+++	++
"Internalisers"	+	+	+	+	0
Pension funds	+	++	+	++	+
<u>*Sub-option C.3*</u> *(EU11, but modifying criteria in Art.4)*					
Add elements of the issuance principle	++	+++	++	+++	+++
Change the order or criteria	./.	./.	./.	./.	./.
Re-establish the power of the "authorisation" criterion	++	+++	++	+++	+++
<u>*Sub-option C.4*</u> *(EU11, but step by step /temporary exemptions)*	++	+	+	0 to +++	0+

* The effects are for within EU11+, as compared to the baseline scenario of non-action.

8. IMPLEMENTATION, MONITORING AND EVALUATION

8.1 Implementation

The proposal for a Directive implementing enhanced cooperation in the area of FTT does not regulate the details of tax collection; it only sets out the basic rules and framework. Typically, the Member States are provided with a large room of manoeuvre among other things to be able to adapt tax collection to national systems and to respect the proportionality principle. Further work with the help of the Commission on the basis of various national experiences should, however, be seriously considered so as to ripe all the advantages of this Single Market initiative, including those of a cost-effective implementation across countries.

8.1.1 Basic rule

Under enhanced cooperation the FTT due should be paid by the financial institution(s) involved in a financial transaction. It appears that this used to be the preferred solution in most Member States that have an FTT in place[69].

These financial institutions are subject to data maintenance obligations either under the MiFID-related legislation or under the proposal implementing enhanced cooperation in order for the competent tax authorities to check the correct payment of the tax. Furthermore, every financial institution liable to pay the tax would need to be properly registered.

The FTT due must be paid to the national tax authorities or to an account determined by the participating Member States at the moment of the transaction in case it is carried out electronically or within three working days from that moment in other cases. Additionally, under the proposal a tax return would have to be submitted to these authorities by the tenth of the month following the month during which FTT became chargeable. As a rule, these obligations hold for both EU established and non EU established financial institutions which are liable to pay the tax.

The next section on monitoring and enforcement provides more information on the data maintenance obligations and on the need for administrative cooperation between States to monitor payment of the tax. For countries that do not have an FTT already in place, laws would have to be passed, systems implemented and people employed to operate it; there will be costs associated with both the initial efforts and the on-going operation of the systems[70].

8.1.2 Other means to collect

Each party to the (taxable) financial transaction becomes jointly and severally liable for the payment of the tax due by a financial institution on account of that transaction, in case that financial institution has not timely paid the tax (safety net). Also, Member States may provide

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[69] See FISCO – The fiscal compliance experts' group (2007) second report – solutions to fiscal compliance barriers related to post-trading within the EU, p. 6.

[70] See the IMF working paper of John Brondolo (2011) – Taxing financial transactions: an assessment of administrative feasibility, p. 14.

that other persons can be held jointly and severally liable for the payment of the tax. Member States would thus have the right to organize tax collection by other means than set out above under the basic rules of the proposal. They could for instance use exchanges/organized trade venues or platforms to pay the tax in case of financial instruments traded on such platforms, alternatively they could use central clearing parties to pay the tax, especially because the use of these central counterparties will become more generalized and average collection costs would be, in general, lower. Member States can assess which systems of tax collection are most appropriate depending on their organization of markets and infrastructure.

Arrangements would need to be set up for (cross border) cases which involve financial institutions in the transaction that are (deemed to be) established in different Member States, because the (central) tax collection point would have to pay the FTT due (at both sides of the transaction) to different national tax authorities. This is a normal tax administration procedure and subject to subsidiarity. However, it might also be envisaged to go for an implementing act by the Commission so as to guarantee an uniform and cost-effective implementation across the participating Member States.

It is logical that also these central tax collection points would have to be registered and to file tax returns. However, it would need to be analysed if it is possible for them to immediately pay the FTT due to the national tax authorities in case of electronic transactions, or whether they themselves should transfer the money at a lower frequency.

FTT payment on pure OTC (over-the-counter) transactions would of course still have to rely upon the basic rules of tax collection (payment by the financial institution involved in the transaction). This is why it is essential to levy the tax on both legs of the transaction[71]. Where OTC transactions are cleared and settled through a clearing house, the tax could be again collected using this central point. This could be the case, for example, for bond trading which – in many countries – is regulated to a certain extent.[72] Otherwise, also securities dealers could be used in practice to collect the tax, like it is the case in Switzerland[73].

Arrangements would also have to be established for recognizing the correct person liable to pay in case of financial institutions transacting in the name or for the account of another financial institution (in which case only the originator is liable). Adding elements of the issuance principle on top of the residence principle could even add up to the complexity.

In conclusion, in assessing the advantages and disadvantages of different collection philosophies, Member States should differentiate between (1) transactions carried out at exchanges, where – unless the burden falls on parties or intermediaries – using central clearing houses could prove to be a cost effective solution and (2) other transactions, e.g. carried out over-the-counter, where the burden could also fall on parties and intermediaries or on the clearing houses used. However, the interaction between the Commission proposal for a Directive implementing enhanced cooperation in the area of FTT and the functioning of the

[71] See IMF/John Brondolo – op. cit, p 14.

[72] See IMF/John Brondolo – op. cit, p. 20.

[73] Securities dealers are: (a) Swiss banks, brokers, and asset managers, (b) among others, Swiss companies or Swiss branches of foreign companies that hold taxable securities with a book value of more than CHF 10 mn. in their balance sheet. For details, visit http://www.admin.ch/ch/f/rs/64.html#641.1 and http://www.efd.admin.ch/themen/steuern/index.html?lang=fr.

central counterparties need to be assessed thoroughly (e.g. in terms of chargeability, cancelled transactions, identification of the person liable to pay the tax etc.).

8.2 Monitoring

Taxing financial transactions is one of the least expensive ways of collecting taxes, as most transactions are carried out electronically and the tax can be collected electronically and at the source. FTT can be collected at very low cost (less than 1% of the foreseen revenue), especially when good use can be made of existing market infrastructures, e.g. with the help of trading platforms, trade repositories or clearing houses.[74]

Nevertheless, concerns have been raised that the tax as proposed would be hard to implement and to enforce as data availability is limited. However, the following sections highlight that the already existing "Markets in Financial Instruments Directive" (MiFID)[75] and the "European Market Infrastructure Regulation" (EMIR) would allow for the payment of the tax to be properly ensured and monitored. These pieces of legislation are to be complemented by the provision for "joint and several liability" as foreseen in Art. 10.3 of the proposal, and that should also encourage voluntary compliance.

8.2.1 Data maintenance and place of keeping at the disposal of data

Pursuant to Art. 25(2) of the current Markets in Financial Instruments Directive (MiFID) investment firms and credit institutions are obliged to keep relevant data relating to all transactions in financial instruments (including OTC transactions) which they have carried out, whether on own account or on behalf of a client. In the case of transactions carried out on behalf of a client, the records shall contain all the information required to identify the client and information required to prevent the use of the financial system for money laundering. The data have to be kept at the disposal of the competent (MiFID) authority for at least five years. It is not mentioned where the data is to be kept, but the competent authority referred to should normally be that of the home Member State which authorises the performance of investment services and activities under MiFID.

The home Member State as a rule is the State where the head office is situated (natural persons) or in which its registered office (legal persons) is situated (Art. 4(20) of the MiFID). Consequently, the information should be easily available in the Member State of authorisation (head office, registered seat).

Some persons, such as (in principle) those only dealing on their own account (unless they are market makers or deal on own account outside a regulated market or a multilateral trading facility (MTF) on an organised, frequent and systematic basis) are not subject to the MiFID.

In order to avoid possible lacuna, Article 11 of the proposal for a Directive implementing enhanced cooperation in the area of FTT provides for the (tax) obligation that where financial institutions are not subject to Article 25(2) of the MiFID they shall keep at the disposal of the competent authority, i.e. the tax authority, for at least five years, the relevant data relating to all financial transactions which they have carried out, whether in their own name or in the

[74] See IMF/ John Brondolo (2011) – op. cit., The Dutch Planning Bureau/CPB (2011) - An evaluation of the financial transaction tax.

[75] The Directive 2004/39/EC is currently in the process of being reviewed by the co-legislator.

name of another person, for their own account or for the account of another person. Member States will be required to ensure that financial institutions comply with this obligation. In view of the above it would be logical that this ("tax") information is kept and readily available in the Member State of authorisation of the financial institution (if applicable) or of its head office/registered seat. This applies per separate legal entity.

Financial institutions with a registered seat or head office located outside the EU but with a branch in a Member State of the EU will normally be authorised as a financial institution by that Member State under national regulations. In that case, the above principles remain valid. In case of multiple branches in the EU, different Member States will be involved and data per branch is to be kept in the Member State of the branch.

Financial institutions which do not have any seat or branch in the EU11+, but are deemed to be established in a Member State of the EU11+ pursuant to Art. 4.1 (e) of the proposal for a directive implementing enhanced cooperation in the area of FTT –- because of transactions with an EU11+ established party or because they are acting in the name of a party to a transaction with an EU11+ established party –- will need to be registered, and keep transaction data at the disposal of the competent tax authorities, in the Member State of establishment of that latter party (cf. Art. 11 of the proposal).

It is also to be noted that the new MiFID II and MiFIR[76] legislative proposals envisage creating a harmonised framework for granting access to EU markets for businesses and market operators based in third countries in order to overcome the current fragmentation into national third country regimes and to ensure a level playing field for all financial services actors in the EU territory. Harmonised rules for third country investment firms with or without an EU branch will be provided for.

8.2.2 Reporting obligations under MiFID and EMIR

Pursuant to Art 25(3) of the current MiFID Member States shall require investment firms which execute transactions in any financial instruments admitted to trading on a regulated market to report details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day. This obligation applies whether or not such transactions were carried out on a regulated market.

According to Art. 54(5) of the MiFID, that Directive does not prevent competent authorities from exchanging or transmitting, in accordance with national law, confidential information that has not been received from a competent authority of another Member State.

Furthermore, the European Market Infrastructure Regulation (EMIR) stipulates that counterparties (financial and non-financial) and central counterparties (CCPs) shall ensure that the details of any (OTC) derivative contract they have concluded and any modification, or termination of the contract is reported to a trade repository or, in the absence of such a repository, to the European Securities Markets Authority (ESMA). A trade repository shall maintain it for at least ten years following the termination of the relevant contracts and shall make the necessary information available to relevant supervisory authorities, including ESMA. Where a trade repository is not available to record the details of a derivative contract, counterparties and CCPs shall ensure that the details of the derivative contract are reported to

[76] Markets in Financial Instruments Regulation.

ESMA. A CCP shall maintain, for a period of at least ten years following the termination of a contract it has processed, all information on that contract.

The recital (58) of EMIR states that "*For the exchange of information, strict professional secrecy is needed. It is essential, due to the wide impact of OTC derivative contracts, that other relevant authorities, such as tax authorities and energy regulators, have access to information necessary to the exercise of their functions*."

It would seem appropriate to provide in national law for access to data held by competent (supervisory) authorities, trade repositories, CCPs, trading venues and ESMA in order for tax authorities to be able to use these data for possible cross checking.

8.2.3 Administrative cooperation

For tax monitoring purposes, Member States will have to ensure well-functioning administrative cooperation both at national and European/international level. Data available at one side of the transaction should be provided to the tax authority competent for the monitoring of the tax payment at the other side of the transaction. From an EU and international perspective, the administrative cooperation tools in place will need to be used effectively. To this end, Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC could be used as from the entry into force of the FTT Directive.

In principle, the current scope of Directive 2011/16/EU is broad enough to include FTT, as an FTT is not covered by the exception in Article 2.2 (i.e. it is not value added tax or an excise duty). This means that apart from the automatic exchange of information, all mechanisms of the Directive would apply to the tax, i.e. exchange of information on request, spontaneous exchange of information; presence in the offices where the administrative authorities of another Member State carry out their duties or presence during administrative enquiries; simultaneous controls. Finally, FTT could also benefit from the sharing of best practices and experience provided by Directive 2011/16.

As regards the automatic exchange of information, the Directive provides for the exchange of available information in respect of a number of defined categories from 1 January 2015 regarding taxable periods as from 1. January 2014. These do not include financial transactions. However, the tax could be included at a later stage in the context of the review of the automatic exchange of information which is due to be submitted before 1 July 2017.

As regards the recovery of the tax, Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures applies since 1 January 2012 and would be applicable to FTT.

The use of the above mentioned EU administrative cooperation tool is outlined in Art. 11(3) of the FTT proposal implementing enhanced cooperation. From a wider international perspective, the Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters could be applicable to the tax given its very wide scope: it covers exchange of information on request, spontaneous exchange of information (for example in case one State has grounds for supposing a loss of tax in the other State), subject to mutual agreement or consultation: automatic exchange of information, simultaneous tax examinations, tax examinations abroad and finally, assistance in recovery and service of documents.

Currently, the Convention applies to Azerbaijan, Belgium, Denmark, Finland, France, Georgia, Iceland, Italy, Moldova, the Netherlands, Norway, Poland, Slovenia, Spain, Sweden,

Ukraine, the United Kingdom and the United States. Some other countries have signed as well, but there is no entry into force yet (Ireland, Korea, Mexico, Moldova, Portugal).

A number of additional countries (Argentina, Australia, Brazil, Canada, Germany, Indonesia, Japan, Russia, Turkey and South Africa) have signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters on 3 November 2011 in the margins of the Cannes G20 summit. The Cannes G20 Summit final communiqué mentioned: "*We welcome the commitment made by all of us to sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and strongly encourage other jurisdictions to join this Convention. In this context, we will consider exchanging information automatically on a voluntary basis as appropriate and as provided for in the convention*". Recently, Costa Rica, India and Greece signed the Convention.

8.2.4 Joint and several liability

Where a financial institution which is liable to pay the tax on a transaction does not pay the tax due within the time limits set, each party to the transaction (including persons other than financial institutions) shall become jointly and severally liable for the payment of the tax on that transaction (Art. 10.3 of the proposal). This is not only an additional measure to ensure payment of the FTT, but for commercial reasons it should also encourage the financial institution liable (in the first instance) to pay the amount of the tax due. Member States may also provide that other persons (e.g. advisors, intermediaries, law firms etc.) are held jointly and severally liable for the payment of the tax.

8.2.5 Audit

The implementation of the tax in the Member States will entail certain audit efforts of their tax authorities. First, tax payments will have to be checked against tax returns. Second, the information included in the tax returns will have to be checked against transaction data and cross-checked with other available data as explained before. It is obvious that IT procedures would have to be developed possibly on an EU-wide basis or with knowledge sharing between Member States. The starting point would be to put in place an accurate register of financial institutions established in the territory of a Member State by using the data of supervisory authorities and that on counterparties mentioned in records on transactions. The establishment in the Member States of dedicated tax audit teams which have or acquire financial sector expertise seems to be an appropriate solution.

In top 50 banks (according to strength) of the Banker's database[77] there are 19 credit institutions which have the headquarters of the banking group located in the EU. For example, it would be sensible to assume that significant financial transactions would be carried out by them and that in the EU/enhanced cooperation zone certain risks of avoidance can be assigned primarily to these entities; in this sense, FTT audits could be carried out preferably on the trading activities of such financial institutions in the first place.

8.3 Review

With developing a common system of financial transaction tax within the FTT jurisdiction with a very broad tax base, also including very mobile tax bases, the European Union would

[77] The Banker Database/FT (2012), Top 50 banks in the world.

to a certain extent enter untested ground. The more important will it be to closely monitor the effectiveness of the common system, detect unwanted side effects (be they economic or social) or new business models successfully circumventing the tax at large scale.

Therefore, it should be envisaged to set up an expert group with participation of Member States, the European Commission, the European Parliament as well as stakeholders and experts. Such an expert group could assist the Commission in the preparatory phase of the elaboration of the delegated acts provided for in the current proposal for a Directive (detailed rules for determining whether an undertaking carries out financial transactions in a significant way so it can be considered a financial institution for the purposes of this Directive, as well as more detailed rules regarding protection against tax evasion, avoidance and abuse). The group should review progress or lack of progress, develops solutions to potential problems discovered and regularly reports back to the Council. It should also provide guidance on how to fix problems discovered and to – if necessary – propose improvements to the overall approach towards taxing financial transactions.

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Annex 1: Taxes on transactions in financial instruments in the EU

Disclaimer: The Commission services bear sole responsibility for this publication and its content. It is based on the Commission services' interpretation and processing of the information obtained from Member States and Croatia as well as other sources as a reply to a questionnaire on the existence of forms of taxes on transactions in financial instruments in the EU.

Based on the replies received from Member States (MS) and Croatia and on various additional information such as the IA of FTT proposal and other sources (such as the IA of the COM proposal for a bank recovery and resolution framework in Europe – SWD (2012) 166/3)[78], it appears that different forms of indirect taxes on financial transactions or transfers of various assets, including financial instruments have been identified in 11 Member States (MS). In general, all these national taxes have a more restricted scope compared to the Commission's proposal, taxing in general the trading in shares and, in some cases, bonds. Most of them do not cover derivatives (options are taxed in BE, CY, FI, FR, IE, MT, PL and UK when they are exercised resulting in the physical delivery of the underlying securities) and some of them are rather in the form of a stamp duty or a transfer/registration tax (CY, FI, IE, FR, MT, PL and UK). All the countries have in place certain exemptions for some financial institutions (e.g. domestic or foreign intermediaries, CCPs, CSDs) and/or for some particular transactions (e.g. primary market transactions, market making, transactions with government bonds, intra-group or restructuring operations etc.). It appears also that 16 MS have bank levies in place.

In general, for securities the chargeability is triggered when the transaction is carried out (transfer of ownership involved), while for derivatives it is the moment the contract is concluded. The time at which the tax is due to the tax authorities varies across countries, from "immediate" liability to several weeks; in many instances, the moment in time is placed during the month following the month of the transaction. In some national systems, also rules on joint and severe liability apply.

The large majority of indirect taxes on financial transactions are levied *ad valorem*; the only exception is LU, who levies a flat tax on a presumed circulation of securities, based on changes in the overall assets of the taxable persons. In IT also, the stamp duty is levied in some cases as a flat tax. Since only a few MS tax OTC transactions and the taxes are collected by using a central point such as the clearing house, they have not explicitly chosen to tax both parties. Nevertheless, in practice the burden of the tax could be borne by either or both the buyer (who pays a higher after-tax price) and the supplier (who receives a lower after-tax price). The tax base is in most cases represented by the price or consideration paid for the acquired securities.

[78] See http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm.

Among the MS authorised to implement enhanced cooperation in the field of FTT, only three MS (BE, FR and EL) have already in place a form of FTT. From these countries, the BE and EL systems are the closest ones to what the Commission has proposed in the first place, having in mind that they use of combination of criteria which includes the residence principle (for BE the focus is rather on where the transaction is concluded or executed, but a professional intermediary needs to be involved to have a taxable transaction – this can be a non BE person if allowed to act on BE market), certain derivatives are taxed, both regulated and unregulated markets are covered (for BE: instruments need to be "public funds" meaning that they can be traded on a public exchange) etc. Nevertheless, there are significant differences in terms of design and operation of these national systems. FR actually taxes a particular form of derivatives – the credit default swaps (CDS) on sovereign debt instruments, based on the notional value, as proposed by the Commission. In November 2012, the IT government submitted a proposal, further amended in December 2012, to implement a national FTT based on a broad definition of the taxable base (derivatives and cancelled orders included) and the principle of the place of transaction. This tax will enter into force as of March 2013 (for securities) and July 2013 (for derivatives). Two other MS authorised to implement enhanced cooperation in the field of FTT (ES, PT) are planning to introduce their own national form of FTT.

A larger "population" of MS having a form of FTT in place is not interested though in entering the enhanced cooperation zone (CY, FI, IE, LU, MT, PL and UK). From this point of view, the harmonisation exercise would be relatively less effective, as the co-existence of the enhanced cooperation tax system and the national systems outside the enhanced cooperation zone could still lead to issues of double taxation, for instance, when a share of a British company is taxed both in the UK and in BE.

No.	Member State	FTT and/or bank levy currently in place (Y/N)		Type of FTT	Tax base	Exemptions	Tax rates	Taxation principle(s) used	Are derivatives taxed? (Y/N)	Revenues (EUR mn.) / Share of FTT revenue in GDP (%) [79]	
1	Austria	N[80]	Y								
2	Belgium	Y[81]	Y	Stock exchange transaction tax	Any purchase or sale of (Belgian or foreign) securities carried out or concluded in Belgium, on both regulated and unregulated markets	Primary market transactions, trading on own account, market making, trading by CCPs and CSDs	0.25% and, and 0.09% for Belgian or foreign sovereign bonds and bills etc., company bonds, units in UCITS and AIFs; 1% for the secondary market of units/shares of an UCITS and AIFs and for their redemption	Place of transaction principle	Y	132.00	0.04
3	Bulgaria	N	N								
4	Cyprus	Y	Y	Stock exchange transaction tax	It applies to financial institutions licensed to operate in CY. It applies to transactions carried out with all types of securities excluding company bonds at the CY Stock Exchange	OTC trade is not covered. Certain types of transactions specified by the law e.g. repurchase of own shares, government bonds etc. are exempted	0.15%	Place of transaction principle	Y [82]	1.4	0.01
5	Czech Republic	N	N								
6	Denmark	N[83]	Y								
7	Estonia	N	N								
8	Finland	Y	Y[84]	Transfer tax	The tax covers transactions in shares issued by companies	Primary market transactions are exempted. If neither party to the transaction is resident	1.6%	Issuance & residence principles	Y	249.00[85]	0.13

[79] Gross Domestic Product, market prices, 2011 data (source: Eurostat).

[80] AT only has a capital duty in place. It needs to clarify though whether transfers of financial instruments within a group (against consideration) are covered by this capital duty (e.g. transfer of a company's seat to Austria). If so, than this would be similar to the provision in Art. 2.1(1) (b) of the FTT proposal.

[81] BE also taxes exchange traded derivatives (futures, options etc.).

[82] Only upon physical delivery (e.g. options).

[83] DK appears to have a stamp duty on insurance policies, soon to be replaced by an insurance premium tax.

					resident in Finland. Shares and interim certificates of share issues, certificates of participation, bonds or other certificates of claim issued by a corporate body, letters of right of subscription and electronic book entries in a computerised trading system	(fiscally) in Finland, or it involves a Finnish branch of a foreign financial institution, the tax is not levied					
9	France	Y[86]	Y	Transaction tax on shares and naked CDS	The acquisition of French shares issued by a company whose market capitalization exceeds EUR 1 bn., high frequency trading tax (cancelled orders above a certain threshold) and naked sovereign credit default swaps (CDS)	For the tax on the acquisitions of French shares: primary market, CCPs and CSDs (except transactions realised on their own account), market making; intragroup and restructuring operations, temporary transfer of securities, employee savings, convertible and exchangeable bonds. For the high frequency trading tax and the naked sovereign CDS tax, only the market making is exempted.	0.2% for the acquisitions of French shares; 0.01% for the high frequency trading tax and the naked sovereign CDS tax.	Issuance & residence principles	Y	1100.0[87]	0.06 N/A
				Registration duty	All (listed and unlisted) corporate entitlements sold in FR are submitted to the registration duty tax. Moreover, the sales of FR corporate	Exemptions for: intra-group operations, when the corporate entitlements are bought back the company which issued it, when the corporate entitlements are	3% when the price of the shares is no more than EUR 200 000, 0.5% if the price is contained between EUR 200 000 and EUR 500 000 000 and 0.25% if the	Place of transaction principle	N	N/A	

[84] FI plans to introduce a bank levy as of 2013 were already included in the draft budget for 2013.

[85] Calculated as an average over the last five years.

[86] A FTT is in place from 1/08/2012. A registration duty was in place already before.

[87] Estimates for the transaction tax. Revenue figures for the transfer duty are not available.

					entitlements taking place abroad are also submitted to the tax.	issued by companies which are going into administration, when the corporate entitlements are issued by companies which are members of an integrated fiscal group and when the corporate entitlements are issued by companies which are undergoing a partial asset transfer	price exceeds EUR 500 000 000. The rates will be of 0.1% from the 1st of august 2012; 3% of the price of the shares in companies where the capital is not divided into stock; 5% of the price of the shares in companies where property buildings owned by the company represent more than 50% of the balance sheet				
10	Germany	N	Y								
11	Greece	Y[88]	N	Stock exchange transaction tax	Sale of shares listed in the Athens stock exchange (ASE), sale of shares listed in foreign stock exchanges or other internationally recognized stock exchange institutions by EL tax residents or enterprises established in EL, OTC transactions and transactions made through multilateral negotiations mechanism.	The tax does not apply to sales of shares listed on the ASE regarding transactions conducted by market makers of ASE and by market makers of Athens Derivatives Exchange (ADEX) to cover risks arising from the implementation of market making obligations, provided such sales are cleared through a special code maintained on their behalf by the CSD	0.2%	Place of transaction & residence principles	N[89]	92.00[83]	0.04
12	Hungary	N	Y								
13	Ireland	Y	Y	Stamp duty	Transfers of stocks or marketable securities	Intermediaries, central counterparties (CCPs), stock borrowing; intra-group transfers, mergers/reconstructions/ amalgamations, American Depositary Receipts (ADRs);	1%	Issuance principle	Y[80]	322.4[83]	0.21

[88] The Greek stock exchange transaction tax ceases to apply for shares purchased from 1/1/2013 onwards.

[89] In the IA accompanying the Commission's proposal, the taxation of derivatives by EL is mentioned though.

						loan capital					
14	Italia	Y[90]	N	Transaction tax	- For sale of shares and other equity securities, the value of the transaction; - Tax on cancelled orders - For transactions on derivative contracts, taxation is fixed and determined by the type and the notional value of contracts	- The issuance and cancellation of shares and financial instruments in certain conditions; - The sale of shares on the regulated markets and multilateral trading systems, securities issued by companies whose average market capitalization in the month of November of the year preceding the transfer is less than EUR 500 mn.; - Transfers of property by inheritance or gift; - Operations conversion into new shares and temporary acquisitions of securities	- 0.2%; - 0.2 %; - Derivatives will be taxed a flat rate between EUR 0.1 and 200 per transaction depending on the type and value of the contracts. For transactions that take place on regulated markets or multilateral trading systems, tax will be reduced to 1/5 and determined by decree according to the average value of a standard contract.		Y		
15	Latvia	N	Y								
16	Lithuania	N	N								
17	Luxembourg	Y[91]	N	Subscription tax (*taxe d'abonne-ment*)	Indirect tax levied on the presumed circulation of assets/financial instruments. It is levied on certain financial institutions residing in LU: (1) family offices, (2) alternative investment funds (AIFs) and (3)	There are some special exemptions concerning the assets and financial instruments included in the tax base	(1) 0.01% and (2) 0.05% of the next assets; (3) 0.25% of the capital with issuance premium included plus a part of the liabilities/debts	Residence principle	N	604.98[83]	1.41

[90] IT has in place a stamp duty on the communications made by traders for financial or financial instruments held or financial contracts concluded for their clients. The legal base is DPR 642 of 1972; Annex II (on the tariffs) mentions 'documents relating to any transfer or receipt of money, securities or other assets', on which a flat rate tax is levied (per page of contract or per item transferred or held). Moreover, IT has in place a registration (flat rate) tax on contracts officially registered by a public notary or under private signature. These taxes have more the characteristics of indirect taxes other than VAT on services related to certain financial activities.

In November 2012, the IT government submitted a proposal, further amended in December 2012, to implement a national FTT based on a broad definition of the taxable base (derivatives and cancelled orders included) and the principle of the place of transaction. This tax will enter into force as of March 2013 (for securities) and July 2013 (for derivatives).

					undertakings for collective investment in transferable securities (UCITS)						
18	Malta	Y	N	Stamp duty	The tax is due on every document whereby marketable securities (share, stock, debenture, bond and alike, including options with physical delivery of such shares and bonds) are transferred	Transactions involving securities listed on a stock exchange recognised under the Financial Markets Act, transactions between spouses or involving trusts etc. are exempted. No duty is chargeable on any restructuring of holdings through mergers, de-mergers, amalgamations and reorganisations within a group of companies defined as: a holding company and its subsidiaries (a company is deemed to be a subsidiary if more than 50% of its voting shares are beneficially owned by its holding company); companies which are controlled and beneficially owned directly or indirectly to the extent of more than 50% by the same shareholder.	(1) A duty of 2 Euro for every one hundred euro or part thereof of the amount or value of the consideration or the real value, whichever is the higher of the marketable security shall be charged. (2) Where it results that seventy five percent or more of the assets, excluding all other current assets other than immovable property of the company whose marketable securities are transferred, consists of any immovable property or any right over an immovable, the duty chargeable shall be increased by 3 Euro for every one hundred euro or part thereof.	Residence principle	Y[iv]	2.12[83]	0.03
19	Netherlands	N	Y								
20	Poland	Y	N	Registration tax (on contracts)	Contracts of sale and exchange of property rights, in particular shares and stock in a commercial company	Primary market transactions are exempted from the tax. Moreover, the tax does not cover financial instruments traded by to investment firms and foreign investment firms, on an organized trading platform, or outside organized	1%	Place of transaction & residence principles	Y[iv]	N/A	N/A

[91] The LU tax is apparently a sort flat rate tax; they are taxing a presumed circulation of securities, based on changes in the overall assets of the taxable persons.

						trading by investment companies and foreign investment companies, if those rights were acquired by these companies in the organized trading.					
21	Portugal	N[92]	Y								
22	Romania	N[93]	N								
23	Slovakia	N	Y								
24	Slovenia	N	N								
25	Spain	N[94]	N								
26	Sweden	N	Y								
27	The UK	Y	Y	Stamp duty; stamp duty reserve tax	Stamp duty – UK stocks and marketable securities which are transferred on sale for consideration. SDRT – chargeable securities i.e. stocks, shares and certain types of loan capital issued or raised by UK companies, which are agreed to be transferred for money or money's worth	Primary market transactions are exempted from the tax. Other reliefs and exemptions: intermediary relief (a principal broker dealer which is recognised as an intermediary by a trading venue and HM Revenue & Customs is subject to relief from stamp duty and SDRT on any purchases of UK securities made as principal), stock lending relief, clearing	Stamp duty and SDRT – 0.5% on transfers of securities although a higher 1.5 per cent charge applies where UK incorporated shares are transferred on sale (or otherwise than on sale) to a depositary receipt issuer or clearance service	Issuance principle	Y[iv]	3987.6[83]	0.23

[92] PT has a stamp duty in place, but it is levied on credits, bank overdraft, premiums, interest and various commissions/fees. Apparently PT also intends to introduce a financial transaction tax in the near future.

[93] Nevertheless, the Romanian Securities Commission is levying fees/parafiscal taxes on various transactions in order to finance its own budget on the basis of Law no. 514 of 2002 for the approval of the Emergency Government Ordinance no. 25 of 2002 regarding the approval of the Statute of the Romanian Securities Commission. Flat rate fees are levied also on derivative contracts.

It is not clear whether the RSC is a public agency as defined by the IMF (in relation to extra-budgetary funds, in the context of the principal-agency model). Nevertheless, their budget is approved by and they have to report to the Romanian Parliament on an annual basis.

[94] However, transfers of shares or units through which one acquires or strengthens the control over a company whose assets are predominantly real estate seem to be taxed. ES also intends to introduce a financial transaction tax in the near future and has discussed a draft law in this sense with the Troika in the context of the support programme for banks. The draft FTT Law was issued in 2012, but no formal announcement on plans to implement such tax has been made.

						relief, charity exemption, unsecured loan capital					
28	Croatia[95]	N	N								

[95] To become a MS of the Union as of the 1st of July 2013.

Annex 2: Taxes on transactions in financial instruments in third countries

Disclaimer: The Commission services bear sole responsibility for this publication and its content. It is based on the Commission services' interpretation and processing of the information obtained from third countries as well as on other sources.

Based on the replies received from the EU delegations in third countries and on other sources of information, 22 countries in the world seem to apply various kinds of financial transaction tax whose rationale is similar to some extent to that of the EU proposal although the design might be completely different (see table).

The scope and the design of these taxes present wide differences according to the different countries. Nevertheless, some common features at a regional level can be observed. Most of the third countries applying a tax on financial activities (the majority of those in Asia) implement a security transaction tax (STT) on secondary trading in shares and/or bonds (e.g. Korea, Taiwan, India – also on trading in futures and options), but Turkey also applies a banking and insurance transaction tax. In many instances, the tax design of these taxes is inspired by the British stamp duty, e.g. China, Hong Kong, Iceland, Malaysia, Namibia (stamp duty on the issue and transfer of shares), Philippines (documentary stamp tax), Switzerland, Turkey. Rarely only, such taxes have a form of special contributions (Honduras). Some countries apply also a form of Specific Business Tax (SBT), e.g. China, Thailand, that applies a kind of Financial Activity Tax.

In addition to shares and/or bonds, some countries also tax derivatives. Some of them tax options solely at the moment of physical delivery (China, Switzerland, Hong Kong, Iceland, South Korea and Thailand) and others "truly" tax derivatives (India, Malaysia and Taiwan) **such as futures and/or options** (based on premiums for instance). For the latter category, the rates are very small (for instance, 0.017% in India, 0.0005% in Malaysia). According to media reports, the government in South Korea decided recently to introduce, besides the stamp duty of up to 5% on shares, a 0.001% levy on the Korean Composite Stock Price Index (KOSPI) 200 index futures trades, and a 0.01% levy on the KOSPI200 index options transactions. This additional tax in Korea would kick in as of 1 January 2016.

There are countries which also tax the primary issuance of financial instruments (e.g. Turkey, Russia); these transactions are specifically exempted in the Commission's proposal for FTT. Repos and reverse repos are taxed in Turkey, Switzerland, China and Thailand; the latter includes it in the scope of its form of FAT called Specific Business Tax. A separate group of countries is made up of those that tax currency transactions or capital/monetary flows (some for the purpose of foreign exchange controls); most are situated in South America and Africa (Bolivia, Chile, Ecuador, Turkey, Congo, Guinea Bissau, Dominican Republic). Some

countries apply a kind of FTT in the form of a fee, for instance, a registration fee (Algeria), a market cost or a foreign exchange control fee (Congo).

Two special cases are represented by the United States and Australia (not included in the table), which impose levies for regulatory purposes which feed into the budgets of the public interest bodies (securities exchange commissions) that supervise their capital markets. The same model was actually implemented in Romania, for example. Still far away from the FTT model proposed by the European Commission, these entities are actually levying fees/parafiscal taxes. It is not clear though whether they can be considered public agencies as defined by the IMF (for extra-budgetary funds, in the context of the principal-agency model).

No.	Country	Type of tax
1.	Algeria	Registration fee
2.	Bolivia	Market costs (fees)
3.	Chile	Stamp duty on money credit transactions
4.	China	Business tax/ Stamp duty on securities transactions
5.	Congo	Foreign exchange control fee
6.	Dominican Republic	Tax on banking transactions
7.	Ecuador	Tax on foreign exchange transactions
8.	Guinea Bissau	Commission on funds transfers out of WEAMU
9.	Honduras	Special contribution of financial transactions
10.	Hong Kong	Tax on "Hong Kong stock"
11.	Iceland	Stamp duty on financial transactions
12.	India	Securities transaction tax
13.	Malaysia	Stamp duty on certain transactions of stock market of Bursa Malaysia
14.	Morocco	*Taxe sur les profits de cession de valeurs mobilières et autres titres de capital et de créance (revenus de cession)*
15.	Namibia	Stamp duty on the issue or transfer of shares/ Draft transfer duty on the sale of shares and members' interests
16.	Philippines	Capital gains tax on the sale, exchange and other dispositions of capital assets Documentary stamp tax; Percentage tax
17.	South Korea	Securities transaction tax Levy on index futures and index options
18.	Switzerland	Financial transfer stamp duty (*droit de timbre de négociation*)
19.	Taiwan	Securities transaction tax
20.	Thailand	Specific business tax/ Tax on invested equities/ Stamp duty
21.	Trinidad and Tobago	Financial service tax Insurance premium tax
22.	Turkey	Banking and insurance transactions tax Stamp duty Resource utilisation support fund