Financial Transaction Tax – Is it legal?

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Overview

– Status
– Impact of ECP FTT
– Is it legal?
  – Are legal conditions for use of ECP complied with?
  – Compliance with Fundamental Freedoms?
  – Compliance with Capital Duty Directive
  – Implementation by participating Member States
– Procedural steps
Status

– 23 May 2012: EP’s legislative resolution: approval, but proposal to extend scope of FTT (“issuance principle”)
– June/July 2012 ECOFIN meetings: no unanimity
– October 2012: official requests by more than 9 MS to initiate “enhanced cooperation” in the area of FTT (ECP FTT)
– 12 December 2012: EP consents to the proposal for a Council Decision, but requests that the “impact assessment” be complemented
– [January] 2013: decision by Council
Impact of ECP FTT

– FTT is intended to create disincentives for transactions that do not enhance the efficiency of financial markets, but
  – No difference in tax rate between high-risk transactions and low-risk transactions, or between harmful transactions and unharmful transactions
    – Derivatives are often hedging transactions – FTT is disincentive to risk management
    – EC forecasted that, in case of an EU FTT, derivatives trading would fall by 70% (best case) to 90% (worst case)
  – Disintermediation (due to cascading effect of FTT)
– FTT ensures that financial institutions make a fair tax contribution, but
  – EC acknowledges that economic cost will be partly passed onto their customers through pricing
    – EC states that FTT will have “progressive distributional effects” (cf. higher income groups will be more impacted as they use more services provided by financial sector)
Impact of ECP FTT (2)

– High relocation risk:
  – Relocation of business from FTT Jurisdictions to non-FTT Jurisdictions (in EU or outside)
– Impact on UCITS:
  – UCITS established in FTT Jurisdictions will loose investors from non-FTT Jurisdictions
  – UCITS Asset Managers in FTT Jurisdictions will loose business from customers in non-FTT Jurisdictions
  – Certain UCITS in FTT Jurisdictions will be closed down (eg Money Market UCITS)
  – EFAMA: *FTT would erode 6 out of 30 years’ worth of contributions in actively managed retirement savings plan*
– Forecast EC: loss of 0.5% of EU GDP due to FTT (if introduced in all EU MS)!
Impact of ECP FTT in Belgium

– Belgium is in favour of participating to the ECP FTT, but unclear whether Belgium understands the damage for its economy?
  – Belgian Tobin tax proposal (2004): applied only to spot currency transactions, whereas FTT does not apply to these transactions
  – Belgium will lose business due to relocation
    – Belgian-based “in-house banks”, financial institutions and Belgian corporates will be worse-off than those in non-participating MS
    – Belgian securities will become less attractive worldwide (if “issuance principle” is introduced)
  – Cost for Belgian customers will increase
    – Impact on Belgian tax policy: TOB will need to be abolished (was component of Belgium’s policy wrt taxation of movable income)
– Should Belgium consider Dutch approach: wait and see whether the outcome is attractive?
Legal conditions for ECP - General

– First time that ECP is used for tax matters
– No guidance on interpretation of legal conditions for use of ECP in tax matters, but Opinion AG regarding action for annulment (initiated by Spain and Italy) of Council Decision authorising use of ECP in the area of the creation of unitary patent protection (12 Dec. 2012):
   – Review by the ECJ should be limited review (cf. separation of powers)
   – Only review whether EU legislature made i) a manifest error or ii) misused its powers or iii) manifestly exceeded the bounds of its discretion
   – But recent case – outside ECP - where a Directive was invalidated by the ECJ, on basis of breach of Charter (Case C-236/09)
Legal conditions for ECP – Art 20 TEU

– ECP "shall aim to further the objectives of the Union, protect its interests and reinforce its integration process"

– Argument EC:
  – Fragmentation of the market due to coexistence of various national forms of FTT, resulting in distortions of competition on account of tax arbitrage, deflections of trade, … particularly of relevance in financial sector where the tax bases are highly mobile by nature and choices often depend on the level of transaction costs and where the risk of cost-driven relocations is high
Legal conditions for ECP – Art 20 TEU

– This justification by EC was already given in context of EU FTT, but does it still make sense in context of FTT introduced by subset of MS?
  – EC had stated itself (in context of EU FTT) that proper functioning of the internal market can only be ensured through action at EU level
  – Are the interests of EU protected and is integration reinforced in case ECP FTT leads to relocation of activities to non-participating MS (or outside EU), cf. statement of EC on high risk of tax-driven relocations?
    – E.g. UCITS IV Directive enables UCITS ManCo located in a MS to manage UCITS in other MS, but this objective will not be achieved due to ECP FTT, as a UCITS Manco in an FTT Jurisdiction will in fact not be able to manage a UCITS in a non-FTT Jurisdiction due to the FTT cost triggered by this UCITS Manco intervention
Legal conditions for ECP – Art 326 TFEU

– ECP “shall not undermine the internal market or economic, social and territorial cohesion. It shall not constitute a barrier to or discrimination in trade between Member States, nor shall it distort competition between them”.

– EC arguments:
  – reducing fragmentation of the market;
  – financial operators outside FTT Jurisdiction will also benefit thanks to harmonisation in the participating MS (as opposed to dealing with various national forms of FTT, which could lead to distortion through non-taxation of double taxation)
Legal conditions for ECP – Art 326 TFEU

– Barrier to trade with companies in participating MS:
  – Asset managers in FTT Jurisdictions will lose business of non-FTT Jurisdictions

– If “issuance principle” is adopted, investors worldwide will prefer investing in securities (or entering into derivatives relating to securities) of non-participating MS over participating MS

– Competition between MS would be distorted, but in favour of non-participating MS, who would benefit from relocation …

– “High frequency trading”: FTT is intended to close down that business, but will simply relocate to non-participating MS (or outside EU)

– Note: according to EC no need to review the initial impact assessment (which covered EU FTT), but EP thinks otherwise
Legal conditions for ECP – Art 327 TFEU

– Any ECP “shall respect the competences, rights and obligations of those Member States which do not participate in it”. (Art. 327 TFEU)
– EC argument: no issue because
  – non-participating MS can decide to keep or introduce a national FTT
  – Taxing rights are attributed to the participating MS only on the basis of appropriate connecting factors
Legal conditions for ECP – Art 327 TFEU

– Financial institutions in non-participating MS are affected, as ECP FTT is also due by:
  – Financial institutions in non-participating MS, due to a transaction with a counterparty in a participating MS (based on fiction that financial institution is deemed resident in participating MS)
  – Branches (in non-participating MS) of financial institutions (in participating MS)
    – Eg transaction between two London branches of eg. German and Belgian bank triggers German/Belgian FTT, even if transaction relates to UK shares – will UK tax authorities audit correct application of German/Belgian FTT rules (no proceeds accrue to UK?)
  – 80% of (EU FTT) affected financial transactions within the EU take place within London …
Compliance with Fundamental Freedoms?

- ECP FTT would be illegal if it violates free movement of capital (including in relation to third parties), freedom of establishment or freedom of services, and no proper justification
- UK branch of Belgian company will be subject to Belgian FTT, but not a UK subsidiary of a Belgian company
  - Companies are free to choose the appropriate legal form in which to pursue their activities in another MS and that freedom of choice must not be limited by discriminatory tax provisions - discrimination between branches and subsidiaries?
    - From host MS perspective: discrimination between subsidiaries and branches would not be allowed (cf. comparable situation);
    - From MS of origin perspective: arguably no comparable situation between foreign sub and foreign branch (eg X Holding BV - Case C-337/08).
  - Also applicable to indirect taxes, or should the VAT model be followed?
Compliance with Fundamental Freedoms?

– “Spot currency” transactions are excluded, due to EC concerns that FTT on such transactions would affect free movement of capital
  – Opinion of ECB (4 November 2004) regarding Belgian Tobin tax proposal: introduction by an euro zone MS of a tax on all exchange transactions involving foreign exchange is incompatible with the Treaty
  – FTT on “currency forward” transactions would also affect free movement of capital, as well as derivatives relating to spot currency and currency forward
Compliance with Capital Duty Directive?

– Initial EU FTT Directive would amend Capital Duty Directive (2008/7/EC - CDD), and EU FTT Directive would have precedence over CDD
  – Also FTT on issuance and redemption of UCITS securities

– ECP FTT will need to respect the provisions of CDD:
  – No tax on the issuance and acquisition by the first holder of financial instruments covered by Art. 5 (2) CDD
Implementation by participating Member States

– National laws implementing ECP FTT will of course need to comply with the ECP FTT Directive
  – If not: legality to be assessed as for any national tax measure
– MS shall *adopt measures to prevent evasion, avoidance and abuse* (no anti-abuse measure in the ECP FTT Directive)
  – Will create legal uncertainty (*Quid* intended objective of harmonisation?)
  – Will avoidance of “cascading effect” (eg avoiding 4 times FTT on the same derivatives transaction) be caught by anti-abuse, or is it legitimate to avoid overkill effect of FTT?
Procedural Steps

– Challenge of FTT Directive before ECJ due to improper legal basis
  – Challenge by MS (within 2 months of publication) – Art 263 TFEU
  – Challenge by interested party – Art. 277 TFEU
– Challenge before Constitutional Court (when Belgian law implements FTT Directive)
  – Challenge by interested party (within 6 months of publication of Belgian law) – preliminary ruling to ECJ
– Challenge of FTT before Belgian Courts
  – Challenge by taxpayer before the Belgian court - preliminary ruling to ECJ
Questions?

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