Financial Services Advisory

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February 14, 2013

The European Financial Transaction Tax Proposal Returns

On 14 February 2013, the European Commission (the "Commission") released draft text for a proposed financial transaction tax Directive (the "Draft Proposal"). If the text is implemented into law a financial transaction tax (FTT) will be payable to the tax authorities in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia, Slovakia and any other European Union Member State that chooses in due course to participate (the "Participating States").

The Draft Proposal seeks to apply the FTT to financial transactions carried out by financial institutions that are party to the financial transaction, either for their own account or for the account of other persons, or acting in the name of a party to the transaction. The FTT applies to transactions where a party is deemed to be established in a Participating State (the "residence principle") and also where financial instrument traded in the transaction is issued in a Participating State (the "issuance principle").

The rate of taxation is not to be lower than 0.1% of the taxable amount for financial transactions that are not related to derivative contracts and 0.01% of the taxable amount for financial transactions that are related to derivative contracts. Any Participating States which currently impose a tax on financial transactions are prevented under Article 15 of the FTT from maintaining such a tax or from introducing a new financial transactions tax.

Background

The Draft Proposal follows an earlier proposal for a European Union-wide FTT tabled by the Commission in September 2011 that sought, *inter alia*, to:

- harmonise legislation concerning indirect taxation on financial transactions;
- ensure that financial institutions make fair and substantial contributions to covering the costs of the recent financial crisis; and
- create appropriate disincentives for transactions that do not enhance the efficiency of financial markets.

It became clear at European Council meetings in June and July 2012 that certain Member States, including the United Kingdom, would not support the September 2011 proposal, thus making a European Union-wide FTT unlikely.

However, the eleven Member States referenced above submitted a subsequent proposal to the Council for enhanced cooperation in regard to the FTT.[i] The aim of this subsequent proposal was to implement a common system of FTT among those eleven Member States and any others who may in due course wish to implement it.

Scope

The Draft Proposal applies to all financial transactions[ii] in financial instruments[iii] provided two conditions are met. The first condition is that a party to the financial transaction is established in a Participating State. The second condition is that a financial institution[iv] (acting on its own account, for the account of another person or in the name of a party to the transaction) is a party to the financial transaction (Article 3.1).

A non-financial institution will be deemed to be established in a Participating State if: (1) it is established in a Participating State;[v] or (2) it is party to a transaction in which financial instruments issued in a Participating State are traded (Article 4.2).[vi]

A financial institution will be deemed to be established in a Participating State if: (1) it is established in a Participating State;[vii] (2) it is party to a financial transaction with an entity established in a Participating State;[viii] or (3) it is party to a transaction in which financial instruments issued in a Participating State are traded (Article 4.1).[ix]

If a non-financial institution or a financial institution is able to demonstrate that there is not a link between the economic substance of the transaction and the territory of any Participating State, the entity will not be considered to have been deemed as established in a Participating State (Article 4.3). "Economic substance" is not defined in the Draft Proposal.

Liability for Payment

The FTT will be payable by each financial institution which fulfills any of the following conditions:

(a) it is party to the financial transaction, acting either for its own account or for the account of another person;

(b) it is acting in the name of a party to the financial transaction; or

(c) the financial transaction has been carried out on its account.

The FTT will be payable to the tax authorities of the Participating State in the territory where the financial institution is deemed to be established (Article 10.1). The Draft Proposal includes a mechanism to identify the jurisdiction in which the financial institution is liable to pay tax in the event that the financial institution may be deemed to be established in more than one jurisdiction (Article 4.4).

If a financial institution (A) acts in the name or for the account of another financial institution (B), Article 10.2 provides that only B shall be liable to pay the FTT.

In the event that the financial institution which is primarily liable has not paid the FTT within a set time limit, the other parties to the transaction will become jointly and severally liable for the payment of the tax due (Article 10.3).

Rates of Taxation

Broadly, a taxable amount is everything which constitutes consideration paid or owed in return for the transfer from the counterparty or a third party (Article 6.1). For financial transactions involving specified derivatives the taxable amount is the notional amount referred to in the derivatives contract at the time of the financial transaction.[x] The rate of taxation is not to be lower than 0.1% of the taxable amount for financial transactions that are not related to derivative contracts and 0.01% of the taxable amount for financial transactions that are related to derivative contracts.[xi]

Time Limits for Payment

The FTT becomes chargeable at the moment when the financial transaction occurs (Article 5.1). If the transaction is electronic, the FTT must be paid at the moment the tax becomes chargeable (Article 11.5(a)). In all other cases, the FTT must be paid within three working days from the moment the tax becomes chargeable (Article 11.5(b)).

Implementation

It is not yet clear when the Draft Proposal will come into force or whether any Member States other than the eleven mentioned above will become Participating States. Some commentators predict that the Draft Proposal may, following certain negotiations as to scope, be implemented by all seventeen Eurozone states or even by all Member States except the United Kingdom and Sweden. The Draft Proposal requires all Participating States to have adopted the laws, regulations and administrative provisions necessary to comply with the Draft Proposal by 1 January 2014. Based on this timetable it is possible that the FTT may come into law in mid to late 2014.

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[i] Enhanced cooperation is possible if it is established that the objectives of the proposed legislation cannot be attained within a reasonable period by the European Union as a whole. At least nine Member States must participate and the cooperation must remain open for any other Member States that wish to join.

[ii] A "financial transaction" is defined in Article 2.1(2) as any of the following:

(a) the purchase and sale of a financial instrument before netting or settlement;

(b) the transfer between entities of a group of the right to dispose of a financial instrument as owner and any equivalent operation implying the transfer of the risk associated with the financial instrument, in cases not subject to point (a);

(c) the conclusion or modification of derivatives contracts before netting or settlement;

(d) an exchange of financial instruments; or

(e) a repurchase agreement, a reverse repurchase agreement, a securities lending and borrowing agreements.

(Certain primary market transactions (e.g., the underwriting of and the initial issue of securities) and restructuring transactions are carved out of scope of the Draft Proposal.)

[iii] Financial instrument is defined in Article 2.1(3). In general, it applies to instruments that are negotiable on the capital market, money-market instruments (except instruments of payment), units or shares in collective investment undertakings (including UCITS and AIF) and derivative contracts. Spot currency transactions are not taxable financial transactions but currency derivative contracts are within scope. Likewise, derivative contracts relating to commodities are covered but physical commodity transactions are not. Structured products including banking securitisations and insurance securitisations are within scope.

[iv] Financial institution is defined in Article 2.1(8). The definition seeks to include investment firms, organized markets, credit institutions, insurance and reinsurance undertakings, collective investment undertakings and their managers, pension funds and their managers, holding companies, financial leasing companies, special purpose entities and other entities carrying out financial activities which constitute more than fifty per cent of their overall average net annual turnover. Central Counter Parties (CCPs), Central Securities Depositories (CSDs), International Central Securities Depositories (ICSDs) and Member States are carved out of the scope of the Draft Proposal; however, the counterparties to these entities are within scope. The carve-out for CCPs, CSDs, ICSDs and Member States only applies insofar as these entities are exercising the function of a CCP, CSD, ICSD or manager of the public debt respectively. The Explanatory Memorandum provides that "trading activity in itself" would not be considered to be within the function of these entities.

[v] A non-financial institution that has its registered seat or a branch from which financial transactions are carried out or (in the case of a natural person) its permanent address or usual residence is deemed to be established in the relevant Participating State.

[vi] A non-financial institution or a financial institution would be deemed to be established in the relevant Participating State if either are party to a financial transaction in which certain specified financial instruments that are traded are issued within the territory of a Participating State.

[vii] A financial institution that has its permanent address, usual residence, a registered seat or is authorised to carry on financial transactions (including by passport or from outside the European Union) in a Participating State is deemed to be established in the relevant Participating State.

[viii] A financial institution is be deemed to be established in the relevant Participating State if it is a party to a financial transaction with either a non-financial institution established in a Participating State or a financial institution established in a Participating State.

[ix] See note vi above.

[x] Specifically derivative contracts that fall within (a), (b), (c) and (d) in note ii.

[xi] I.e., those derivative contracts falling within (a), (b), (c) and (d) in note ii.

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2/14/13