AmCham EU's background paper on the Financial Transaction Tax

Date: 11/04/2013

This Background Paper has been **finalised.**

This background paper is made up of:

- Two letters (for participating and non-participating Member States) which we have been circulated to national AmChams who have forwarded them to their respective governments;
- A briefing note that explains the impact of the FTT on the economy. This has also been sent to the national AmChams to encourage a discussion on this issue within their membership.

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Participating Member State

Dear …

AMCHAM introduction

AMCHAM [ ] wishes to express its grave concerns, over the potential consequences of the “enhanced cooperation” Member States adopting the EC’s proposal for a Financial Transaction Tax (FTT). (Proposal for a Council Directive 2013/0045.). The FTT was originally intended to "*ensure that financial institutions make a fair contribution to covering the costs of the recent crisis*" and *"to create appropriate disincentives for transactions that do not enhance the efficiency of financial markets*". However, the Commission's proposal goes much further and will have serious implications not just for financial institutions but for the "real economy" - on businesses in every sector who legitimately use financial instruments in the normal course of their business, for example to manage risk. We therefore urge [ ] to ensure that the consequences of the proposal are very carefully assessed and understood before any agreement is reached.

The very wide scope of the proposal brings the threat of many and substantial damaging consequences to citizens of [ ] and to businesses operating in the “real economy”, at a time when business is expected to drive economic growth. AMCHAM’s members currently make a significant contribution to the economy of [ ] and the FTT would have a significant impact on their ability to do so. The measure will make the EU and particularly the participating Member States, including [ ] a less attractive place to do business for both domestic and international firms.

The direct implications of the proposal potentially include providing fiscal disincentives for businesses to:-

- raise capital and finance operations;
- hedge commercial risks, including, but not limited to, currency, interest rate and commodity;
- effectively pool and manage cash surpluses and deficits through treasury companies and appropriate short term instruments;
- centralise risks within groups to effectively and efficiently manage them;
- provide pension arrangements for employees;
- tap capital markets for funding, further increasing dependency on banks while at the same time, restricting banks’ ability to provide such funding;
- protect themselves against risk of default by counterparties by seeking to perfect title in security arrangements.

Such costs may be suffered directly where the financial instrument is itself chargeable or because the entity itself is considered a financial institution (we would particularly note the extremely wide definition in Article 2, which will attract not only banks and financial companies, but also certain treasury centres of industrial or trading companies in the course of normal funding of their business operations). Because of this, several of the concepts referred to in the proposal should be defined or clarified, to avoid discussions on interpretation of what is in or outside the scope, and to ensure the wording of the proposal is aligned with what it is intended to cover and is applied consistently.

The costs may also be suffered indirectly where the cost of providing the financial instrument or service is increased by the FTT or indeed makes it unavailable, e.g. AAA money market funds. Similarly, Government Bonds will be particularly adversely affected by the FTT in their own right (e.g. application of the FTT to repo markets when both financial and non-financial companies participate). This will also adversely impact

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all transactions which are priced by reference to Government Bonds or which involve the transfer of ownership of Government Bonds.

The very limited nature of the exemptions, together with the cascading nature of the charges, makes these costs even greater and in turn the FTT as proposed even more damaging.

It is inconceivable that the introduction of a tax can raise the revenues suggested for FTT without damaging the broader economy. To hold informed discussions and make appropriate decisions, it is critical that the substantive consequences for business and citizens are fully identified and analysed in cooperation with the various stakeholders, including industrial, commercial or service MNEs and SMEs.

Yours sincerely,

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Non Participating Member State

Dear …

AMCHAM introduction

AMCHAM [ ] wishes to express its grave concerns for business in [ ], over the EC's proposal for an "enhanced cooperation" Financial Transaction Tax (FTT). (Proposal for a Council Directive 2013/0045.) The FTT was originally intended to "*ensure that financial institutions make a fair contribution to covering the costs of the recent crisis*" and *"to create appropriate disincentives for transactions that do not enhance the efficiency of financial markets*". However, the Commission's proposal goes much further and will have serious implications not just for financial institutions but for the "real economy" - on businesses in every sector who legitimately use financial instruments in the normal course of their business, for example to manage risk. Even though [ ] has not joined the enhanced cooperation process ("FTT zone"), we urge that the consequences for [ ], in particular the extraterritorial nature of the FTT of the proposal be very carefully assessed and understood before the negotiations are allowed to conclude.

AMCHAM's members currently make a significant contribution to the economy of [ ] and the FTT as proposed would have a significant impact on their ability to do so. The measure will make the EU generally, including [ ], a less attractive place to do business for both domestic and international firms.

Businesses operating in the FTT zone will suffer seriously, which in the Single Market will impact businesses in [ ] indirectly. The proposals also seek to tax businesses in [ ] directly in a range of circumstances, which cannot be avoided. As the FTT zone seeks to protect its intended tax base, it imposes FTT on the "real economy" of [ ]. Examples of these consequences for the "real economy" of [ ] are:-

> **Directly** – "financial institutions" are extraordinarily widely defined, including [ ] pension funds and significant group treasury companies. Such companies will be subject to FTT when conducting financial transactions with any FTT zone counterpart. Because of this, several of the concepts referred to in the proposal should be defined or clarified, to avoid discussions on interpretation of what is in or outside the scope, and to ensure the wording of the proposal is aligned with what it is intended to cover and is applied consistently.
>
> **Directly –** the FTT will detrimentally impact money market funds and repos. This will disable banks and wider corporates from the ability to fund themselves, reducing credit extension to wider corporate and end users, increasing risk for cash investment in European entities and increasing costs of capital for cash borrowing entities.
>
> **Directly** – under the newly added "issuance principal", such "financial institutions" will be taxed on their global transactions where the underlying financial instrument has been issued within the FTT zone.
>
> **Indirectly** – the proposal provides fiscal disincentives for FTT zone businesses to enter into sound risk management, which will increase the risk of doing business with them. In a single market it is very hard to isolate one section of the market and insulate the rest.

It is inconceivable that the introduction of a tax can raise the revenues suggested for FTT without damaging the broader economy. For example, Government Bonds will be particularly adversely affected by the FTT in their own right (e.g. application of the FTT

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to repo markets when both financial and non-financial companies participate). This will also adversely impact all transactions which are priced by reference to Government Bonds or which involve the transfer of ownership of Government Bonds. Government bonds of participating Member States will be taxable worldwide as long as a "financial institution" is party to the transaction. Government Bonds of non participating Member States will also be taxed where the conditions of Article 3 are met. On top of this the steps taken to ring fence the tax base will cause extraterritorial taxation that can only be damaging to business in [ ]. It is therefore critical that the consequences of the negotiations and the final form of any FTT are fully assessed and understood.

Yours sincerely,

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AMHAM EU – Tax Task Force
EU Financial Transaction Tax – A briefing
March 2013

The following note provides a brief outline of an initial understanding of the EU Financial Transaction Tax (FTT) proposed for a group of EU Member States.

AMCHAM EU does not offer tax advice. This briefing paper is an understanding of the current proposal which is being considered by the European Union. Specific professional advice should be obtained in respect of any transactions.

How does it affect the "real economy"?

While the FTT is levied on financial institutions established in the EU, it will impact the "real economy" both directly and indirectly, with potentially significant costs. **Critically the definition of "established" and "financial institution" are extremely wide and make the framework potentially directly applicable to the full range of AMCHAM EU members and not only the financial sector.**

The FTT proposed is not a tax on transactions it is a tax on growth. Even if "financial institution" is more narrowly defined, this will not protect "real economy" from the negative effects of the FTT. The FTT would still apply to the heart of the provision of financing – repos. As such it will fundamentally curtail the provision of finance to the "real economy" from the financial sector.

In addition, The EU FTT as drafted will **not only apply to financial institutions established in the "participating Member States"**, but has an extraterritorial reach making it applicable to financial institutions in non participating Member States (and indeed worldwide) when dealing with EU customers. Further, financial institutions worldwide will be subject to the tax globally, when dealing in securities issued within the "participating Member States" (issuance principle).

What difference does it make for business if a particular Member State participates?

Companies in non participating Member States may be taxed given normal definitions of where a company is "established" and whether it is a "financial institution" do **NOT** apply. Costs may be incurred:-

•**directly** where the financial transaction is itself chargeable or because the entity itself is considered a financial institution.

•**indirectly** where the cost of providing a financial instrument or service is increased by the FTT or indeed makes it unavailable.

a)Participating Member States

The very wide scope of the proposal brings the threat of many and substantial damaging consequences to businesses operating in the "real economy", despite claims to the contrary. The direct implications of the proposal potentially include providing fiscal disincentives for businesses to:-

- raise capital and finance operations;
- hedge commercial risks, including, but not limited to, currency, interest rate and commodity;
- effectively pool and manage cash surpluses and deficits through treasury companies;
- centralise risks within groups to effectively and efficiently manage them;
- provide pension arrangements for employees;

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- • tap capital markets for funding, further increasing dependency on banks while at the same time, restricting banks' ability to provide such funding;
- protect themselves against risk of default by counterparties by seeking to perfect title in security arrangements.

b)Non participating Member States

Businesses operating from outside of the FTT zone will also suffer, both directly and indirectly. Examples of these consequences are:-

- **Directly** – the broad definition of financial institution means "real economy" companies, such as pension funds and significant group treasury vehicles, may be taxable when transacting with any FTT zone companies.
- **Directly –** the FTT will detrimentally impact money market funds and repos. This will disable banks and wider corporates from the ability to fund themselves, reducing liquidity in the financial markets, increasing risk for cash investment in European entities and increasing costs of capital for cash borrowing entities.
- **Directly** – the "issuance principal" means that for financial instruments issued within the FTT zone, FTT will be due by such "financial institutions" on their global transactions
- **Indirectly** – the disincentives noted above for FTT zone businesses e.g. to enter into sound risk management will increase the risk of doing business with them.

More detailed questions and Answers are set out in the Appendix

Appendix

AMHAM EU – Tax Task Force
EU Financial Transaction Tax – A briefing
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Which are the "participating" Member States which will apply the FTT?
The following 11 "participating" Member States have requested enhanced cooperation - Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia.

What happens to the other Member States?
The other "non participating" Member States may join in as the negotiations take place. The Netherlands has expressed interest, but this is conditional on pension funds being exempted. Others such as UK and Ireland are very unlikely to join.

It should be noted that the EU FTT may nonetheless apply to "financial institutions" in non participating Member States and indeed worldwide – please see below.

What is the process which will dictate the shape of the FTT?
An EU wide FTT applicable in all Member states was rejected by the Member States. Agreement was reached to allow a subset of Member States to adopt a common FTT through the "enhanced cooperation" procedure. This procedure is untested in the field of taxation.

The European Commission (EC) has produced a revised proposal (2013/0045), which will be subject to negotiation between the "participating" Member States.
This note is an **initial understanding of the EC proposal, which is extremely wide** in its application (e.g. geographic scope, taxable securities and derivatives, taxable persons) but all elements are subject to this negotiation. The exact form of the FTT, e.g. the maximum and minimum rates, the scope of any exemptions and the start date are all subject to the negotiation.

The "participating" Member States will negotiate the Commission's proposal to agree the form. While the Directive will be effective, each Member State will then need to adopt the measure in to national legislation.

Who will pay the EU FTT?
The FTT is payable by:-

- Any financial institution established in a participating Member State (currently Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia) transacting in any financial instrument wherever their customer is established.
- Any financial institution established in any other country in the world (not only EU) whenever they deal with a customer established in a participating Member State
- Any financial institution worldwide wherever their customer is established when transacting securities issued within participating Member States

Where two such financial institutions deal with each other, **both pay the FTT.**

Who are financial institutions?

The definition is **very wide**, beyond regulated firms to include (e.g. central counter parties, insurance, pension funds, UCITS, alternative investment funds, securitisation vehicles).

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The definition (Article 2) also applies to any person where the **average value of its financial transactions exceeds 50% of its overall average net annual turnover** (e.g. while it is a company specific test one would expect many treasury companies to be included)

Can a "real economy" company become liable?
Yes. If it is considered a "financial institution" it is taxable in its own name. Even if it is not, each party to a transaction becomes "jointly and severally" liable for the FTT where the tax is not collected, which may be particularly relevant when dealing with non EU counterparties.

What instruments will the FTT apply to?
Any financial instrument *(refer to EC Directive 2004/39/EC)*
Any derivative *(refer to EC Directive 2004/39/EC)*
At present there are no exemptions for Government Bonds

What transactions does it apply to?
Financial transaction is very widely defined to include purchase and sale, repo, reverse repo and stock loan, intra group transfers and the conclusion of derivatives. The material modification of all such transactions is also taxable.
Where market transactions are settled with transfers as principal, each will potentially be taxable, producing a cascading charge.
There is a relief so that repo, reverse repo and stock borrow and loans will only attract one charge. There is no provision dealing with postings of collateral involving transfers of title and it is likely that such transfers are taxable with no relief from a double charge.

Are there exemptions?
Yes, but currently they are very limited. In particular there are **no exemptions for group transactions or market maker activities**.
The exemptions proposed include for:-

- primary market activity,
- transactions by national central banks and the ECB, EFSF, ESM and in some circumstances with the EU and EAEC
- transactions by CCPs, CSDs and ICSD and with Member States, including public bodies managing public debt – note this exemption does not extend to their counterparts
- bodies granted immunity under EU Protocol to the extent of that protection and similar international organisations

Are transactions within a group exempted?
No. The FTT will apply to taxable transactions within a group where one of the companies is considered to be a financial institution. The FTT due is then calculated by reference to "market price".

What is the rate?
The exact rates will be set by each Member State. Currently the proposal is that the **minimum rates** will be:-

- 0.1% for securities and
- 0.01% for derivatives.

The wide scope of the transactions it applies to means that the charge may be many multiples per "transaction" as one may recognise it e.g. cascading effect.

When will it start?
The current proposal is for the FTT to apply from 1 January 2014. While the negotiations might be expected to delay the start, the political drivers of the agenda mean that such start date, at least in part, cannot be dismissed.

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There is much uncertainty about the negotiations and the possibility of a phased introduction is sometimes the subject of speculation

Are there anti- avoidance measures?
Yes, participating Member States may adopt anti-avoidance measures in their domestic legislation.
In addition the EC has proposed a “general anti abuse rule”, designed to counter artificial arrangements to avoid tax.
Extensive subjective criteria will need to be addressed to accurately determine the applicability of FTT to transactions. The introduction of general “anti-abuse” provisions will introduce yet further uncertainty into this process and in accurately determining the liability of the vast number of transactions potentially subject to FTT.

Depository Receipts (DRs) in respect of underlying securities issued within participating Member States taxable?
Yes potentially, but the manner in which this arises is not straightforward. The Directive has been amended from the original draft, which explicitly included DRs where the underlying security was issued within a participating Member State.
The proposal now treats such DRs as taxable if they are issued with “the essential purpose of avoiding tax” (which is to be assessed by reference to whether trading in the DRs has replaced trading in the underlying) unless the taxpayer proves otherwise. It is not clear at this point, how this assessment is to be made and what proof will be required. Therefore a DR issued over a security issued in a participating Member State, may be taxed on a worldwide basis where the DR is issued within the same participating Member State, another participating Member State and potentially anywhere else in the EU or beyond.

What will happen to the existing FTTs?
In principle, the existing FTTs of participating Member States e.g. those recently adopted in France and being introduced in Italy would be superseded and abolished.

Will the FTT’s be consistent amongst “participating” Member States?
Yes and no. The form of the tax will be dictated by the Directive agreed by the “participating” Member States, but each will need to adopt the measures into the national legislation so there will be some scope for differences. At a minimum, each country will set its own rate.
It is also proposed that the EC be granted powers to specify such requirements as to registration, accounting, reporting and other obligations.

Is AMCHAM EU engaged?
AMCHAM EU has been active in voicing its opposition to the FTT proposal at an EU 27 level. It believes that the debate on enhanced cooperation FTT needs to be conducted with a proper understanding of the consequences of the proposal for the real economy and for individual citizens.

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AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate U.S. investment in Europe totaled €1.7 trillion in 2010 and directly supports more than 4.2 million jobs in Europe.

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