

# The European Financial Transaction Tax: Webinar Takeaways

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On April 3, 2013, James Anderson and Chris Hutley-Hurst of Skadden's tax controversy team in London delivered a live webinar on the EU's proposed Financial Transaction Tax (FTT) and its potential impact on clients conducting business from the United States.

A Europe-wide FTT previously had been proposed in September 2011 but rejected by certain EU Member States (including the U.K.). As a result, 11 EU Member States (the FTT Zone)<sup>1</sup> are in the process of agreeing on the form of an FTT that is targeted to be introduced by each member within the FTT Zone on January 1, 2014. The webinar explored the current draft of the FTT proposal, its legality and the scope for challenging it.

## Scope & Impact

- Very wide, extraterritorial scope.
- FTT is a tax on "financial transactions," applying on a transaction-by-transaction basis to a large range of deals – both OTC and on-exchange – including sales, purchases, exchanges, repos, securities loans and redemptions involving a wide range of instruments, such as equities, debt securities, structured products, partnership interests and units in collective investment undertakings. Both the entering into and trading in derivatives are subject to the tax. Primary market transactions, certain corporate restructurings, loans and spot FX currency trades are not within the FTT's scope.
- Barter transactions will be treated as two separate sales and taxed twice, whereas repos and reverse repos will be treated as one transaction. Notably, fund issues will not be subject to an FTT – but fund redemptions will. It is unclear whether the posting or return of collateral would be subject to an FTT.
- "Material modifications" to a transaction create a new, separate transaction of the same type as the original deal.
- Each "financial institution" (FI) (defined to include banks, brokers, funds, pension funds and certain holding companies) that is party to a financial transaction can be charged an FTT in relation to that transaction, if it is "established" within the FTT Zone for FTT purposes. An FI, wherever located, can be "established" within the FTT Zone if it: <sup>2</sup>
  - is established in any of the FTT Zone Member States by virtue of regulatory authorization, incorporation, branch, permanent address or usual residence (and

<sup>1</sup> The FTT Zone Member States are Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain.

<sup>2</sup> A financial institution can be excluded from a charge if it can show that there is no link between the economic substance of a transaction and the FTT Zone Member State in question. This exclusion is expected to have limited, if any, scope.

where incorporated in a FTT Zone Member State, all branch transactions throughout the world will be subject to the tax); or

- enters into a financial transaction with any person (whether or not that person is an FI) who is established in any of the FTT Zone Member States by virtue of regulatory authorization, incorporation, branch, permanent address or usual residence; or
  - is not otherwise subject to an FTT by virtue of the above, and transacts with anyone where the subject matter is a financial instrument or structured product, other than an OTC derivative, that is issued by a person incorporated in a FTT Zone Member State.
- Each FI that is a party to the transaction is separately taxed, regardless of whether it transacts as principal or agent.
  - Each FI that is taxed will be liable for its own FTT charge, and jointly and severally liable for the FTT charge of any other party to the transaction. Other persons also can be jointly and severally liable. However, if the FI is acting as agent for another FI, it can be excluded from its own FTT charge, although it will be jointly and severally liable for the FTT charges of other parties to the transaction, including its client's charge.
  - There are some limited exemptions. For example, international central securities depositories, such as DTC, Euroclear and Clearstream will be exempt, although their counterparties will not.
  - No key exemptions for market makers, brokers or intermediaries such that the overall tax cost of a transaction can cascade as each leg of a transaction can be taxable.
  - FTT Zone Member States will set their own FTT rates with a minimum rate of 0.1 percent or 0.01 percent for derivatives. The tax ignores the tenor of a transaction, and so a series of short-term deals can lead to higher FTT costs. The tax applies to transactions before any netting or settlement, so intraday trading will not avoid the tax. A cancelled trade can still attract an FTT unless it was entered into in error.
  - Double tax charges can arise where the subject matter of the transaction also is subject to transfer taxes outside the FTT Zone.
  - There are general and targeted anti-abuse rules that allow a review of depositary receipts in certain circumstances. The scope of these anti-abuse rules is wide (for example, no actual intent to avoid the tax is needed), and they create uncertainty in many situations.

### Legality & Challenge

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- There is a good argument that the proposed FTT distorts competition, as the tax will become a factor in situations where an FI outside the FTT Zone is deciding on which counterparty to use. In addition, there are arguments that the FTT breaches fundamental EU rights, such as the freedom of establishment and free movement of capital.
- As a result, there is a good argument that the proposed FTT is in breach of a number of EU law provisions relating to the legal basis for, and the procedural rules for establishing, the proposed FTT.
- Challenge to the FTT proposal could take one of two forms. A challenge could be brought via the action for annulment where the Court of Justice of the European Union (CJEU) would be asked to review the legality of the FTT. Whilst EU Member States have automatic standing to bring such an action, private parties must satisfy a difficult requirement of proving "direct and individual concern." An alternate challenge would require proceedings to be commenced in a national court. That court would then be asked to seek a preliminary ruling from the CJEU. The courts of certain EU Member States may prove more amenable to such a challenge. In terms of timing, there may be scope for the latter challenge to be more rapid, with possible resolution for the latter (but not the former) before the FTT enters into force.