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European Council's Lawyers Opine That Proposed EU Financial Transaction Tax Is Unlawful

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The European Council Legal Service has issued an opinion that seriously questions the legal validity of the European Commission's proposals for a financial transaction tax (FTT). The opinion finds that the extraterritorial application of the FTT's "residence principle" (as described below) is contrary to European Union (EU) law as it:

- infringes the rights of the EU member states who are not seeking to implement the FTT;
- infringes customary international law as it exceeds member states' jurisdiction for taxation;
- is discriminatory and is likely to lead to a distortion of competition to the detriment of non-participating member states; and
- would constitute an obstacle to the free movement of capital and services.

The first two of these findings echo pleadings made by the United Kingdom in its own legal challenge of the FTT (see below).

Background

On 14 February 2013, the European Commission issued a proposal for a FTT which is slated to be introduced in 2014. Eleven "participating" EU member states, including Germany, France and Italy but excluding the U.K., are currently planning on implementing the FTT via a procedure known as "enhanced cooperation."

Broadly, the proposed FTT applies to a wide range of financial transactions and would subject any financial institution located anywhere in the world to FTT charges on any financial transaction to which it is a party where it:

- is established within a participating member state (*e.g.*, it is incorporated or has a branch in that member state) — this is known as the "residence principle";
- is established outside a participating member state but transacts with any person who is established within a participating member state (*e.g.*, it is established in the United States but transacts with a counterparty established in Germany) — this is also part of the "residence principle" and is the subject of the European Council Legal Service's opinion; or
- transacts over certain securities issued within a participating member state (*e.g.*, it and its counterparty are established in the United States but the transaction is over shares issued in France) — this is known as the "issuance principle."

The FTT rates are up to 0.01 percent for transactions involving derivatives and 0.1 percent for transactions involving other financial instruments. The FTT proposal has been widely criticised for both its extraterritorial application and lack of key exemptions, that can lead to a "cascade effect" where, as is common, there are a number of intermediaries involved (each of whom could be charged) in what is economically a single transaction.

In addition, it is understood that participating member states have various concerns over the proposal, including the inclusion of sovereign debt within the scope of the tax and the practical mechanics of enforcement and collection of the tax.

The United Kingdom has already issued a legal challenge to the use of enhanced cooperation for implementing the FTT, pleading that the enhanced cooperation:

- does not respect the rights and competences of non-participating member states;
- infringes customary international law as there is not a sufficiently close link between the member state levying the tax and the taxpayer; and
- causes non-participating member states to suffer tax collection and implementation costs.

The first two of these findings are echoed in the European Council Legal Service's opinion.

Skadden Comment

The European Council Legal Service's opinion is a significant blow to the FTT proposals. Despite wide criticism of the FTT proposals from both governments and industry within and outside the participating member states, as well as the legal challenge by the United Kingdom and the reasoned opinion issued by Sweden, the European Commission has maintained that the FTT proposals are lawful. This latest development is likely to cause the European Commission to reconsider the scope of the proposals.

It is also interesting to note that it is the European Council's authorisation of the use of enhanced cooperation that is being challenged by the United Kingdom, so this legal opinion may be a precursor to the European Council revisiting its decision to authorise enhanced cooperation.

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For earlier coverage of the FTT, please see page 51 of the "Financial Regulation" section of *Skadden's 2012 Insights*.