

European Court Rejects UK's Financial Transaction Tax Challenge

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Tim Sanders

London
+44.20.7519.7039
tim.sanders@skadden.com

James Anderson

London
+44.20.7519.7060
james.anderson@skadden.com

Chris Hutley-Hurst

London
+44.20.7519.7176
chris.hutley-hurst@skadden.com

Jonathon Egerton-Peters

London
+44.20.7519.7159
jonathon.egerton-peters@skadden.com

* * *

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

Skadden, Arps, Slate, Meagher & Flom (UK) LLP
40 Bank Street, Canary Wharf, London, E14 5DS
Telephone: +44.20.7519.7000

Four Times Square, New York, NY 10036
Telephone: +1.212.735.3000

WWW.SKADDEN.COM

On April 30, 2014, the Court of Justice of the European Union rejected the U.K.'s challenge to the proposed financial transaction tax (FTT), while recognizing that the U.K.'s challenge was precautionary — and possibly premature.

The U.K. was challenging the European Council's Decision 2013/52/EU to authorize the "enhanced cooperation procedure" (ECP) in the area of FTT (the Decision). ECP is a mechanism that can be used to implement EU law where there is insufficient support from all EU member states to a proposed law, but more than nine participating EU member states desire to have the law apply to them.

In its challenge, the U.K. argued that the Decision infringes:

- ECP rules and customary international law because of the extraterritorial effects of the proposed FTT, which will fail to respect the competences, rights and obligations of the nonparticipating EU member states; and
- ECP rules, as the implementation of the proposed FTT inevitably will cause costs to be incurred by the non-participating states.

The European Court rejected the U.K.'s arguments but made clear that, in the present case, it only could review the legality of the Decision (to authorize the use of ECP to implement an FTT), and not the legality of any FTT proposals to be adopted as a result of the ECP, which could be the subject of an entirely separate review if those proposals are challenged at the appropriate time.

Background

On February 14, 2013, the European Commission issued a proposal for an FTT that was slated to be introduced in 2014. Eleven participating EU member states, including Germany, France and Italy, are planning to implement the FTT via ECP; the U.K. does not plan to do so. The Decision to authorize ECP was issued by the European Council on January 22, 2013.

As it is currently proposed, the 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 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 U.S. but transacts with a counterparty established in Germany) — this "counterparty principle" is also part of the "residence principle"; or
- transacts over certain securities issued within a participating member state (*e.g.*, it and its counterparty are established in the U.S. but the transaction is over French shares) — this is 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 caused much concern and controversy. It has been widely criticized for both its extraterritorial application and lack of key exemptions, which 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 U.K. challenged the Decision to authorize ECP on April 18, 2013. Subsequent to this challenge, the European Council Legal Service issued an opinion that seriously questioned the legal validity of the European Commission’s FTT proposals.¹ The opinion found that the extraterritorial application of the FTT’s “residence principle” was contrary to EU law as it:

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

Some of these arguments echo the U.K.’s in its challenge of the Decision. In response to this opinion, the European Commission issued a “nonpaper” generally refuting the European Council Legal Service’s arguments.

Comment

The U.K.’s challenge most likely was precautionary (which the European Court recognized), so as to preserve the U.K.’s ability to challenge any final FTT proposals to be adopted as a result of the ECP and prevent any argument that any such challenge of those proposals was time-barred as the Decision was not challenged.

The European Court’s decision does not mean that the FTT as currently proposed is lawful; it simply means that ECP is a legitimate mechanism to implement an FTT in participating EU member states. However, any final FTT proposals that result from the ECP must accord with EU law and could be the subject of a challenge at the appropriate time if it was felt that they did not.

The European Court’s decision also does not mean that the proposed FTT will be enacted in its current form. The ECP is ongoing, and the participating E.U. member states are still in discussions as to the form and content of a viable FTT. An imminent announcement, possibly containing revised FTT proposals, is widely anticipated, and there is a general expectation that, at least initially, the proposed FTT will be much narrower in scope than the current proposals, and more akin to U.K. stamp duty and the current French and Italian FTTs.

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

¹ See “European Council’s Lawyers Opine That Proposed EU Financial Transaction Tax Is Unlawful” (Sept. 10, 2013), available at <http://www.skadden.com/insights/european-councils-lawyers-opine-proposed-eu-financial-transaction-tax-unlawful>.

About Skadden's Global Tax Controversy Practice

Skadden's Global Tax Controversy Practice combines the skills of experienced tax practitioners and dispute resolution lawyers. The group provides its clients with tactical and technical advice to ensure that tax disputes and investigations are resolved as effectively as possible through various methods such as negotiation, expert determination, or a hearing before the tribunals or the courts. The group also provides preventative advice allowing clients to ensure that their tax affairs are legally compliant with a view to avoiding lengthy and costly disputes. Members of the group are named as leading tax controversy lawyers in *International Tax Review's 2013 Tax Controversy Leaders Guide*.