

06 August 2013



Mr Heinz Zourek
Director General, Taxation and Customs Union
Directorate-General, Taxation and Customs Union
European Commission
B-1049 Brussels
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Dear Mr Zourek,

Issue 178: Financial Transaction Tax

The role of the Financial Markets Law Committee (the “**FMLC**” or the “**Committee**”) is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

The FMLC considers it important to comment on legal uncertainties arising from the draft Directive for a Financial Transaction Tax (“**FTT**”) under “enhanced cooperation”, as proposed by the European Commission on 14 February 2013. The FMLC's main areas of concern in this regard are summarised below and are categorised into uncertainties relating to:

- i. the application of the FTT to different types of market transaction;
- ii. the persons liable for the FTT, the manner of collection and enforcement; and
- iii. the application of the anti-avoidance provisions.

A letter discussing the concerns of the FMLC regarding the impact of the FTT on pre-existing market transactions has been sent to Jonathan Faull at DG Internal Market and Services, as the FMLC believes that such concerns are also relevant to the functioning of the internal market. A copy of that letter is enclosed.

Copies of both letters have also been sent to Vaidotas Linkevicius (Attaché for Fiscal Affairs) at the Lithuanian Presidency and Sharon Bowles MEP (Chair of the ECON Committee) at the European Parliament.

Application of the FTT to different types of market transaction

The proper application of the FTT to various types of transaction is uncertain and requires clarification.

The treatment of movements of securities during the term of repo, reverse repo or stock-lending / borrowing transactions for the purposes of the management of financial collateral (*e.g.*, substitution or daily movements of collateral) requires clarification, as there is material uncertainty as to whether such transactions should be treated as separately chargeable “financial transactions”, for the purposes of the FTT.

Technical guidance published by DG Taxud suggests that CCPs will be subject to a “look-through” principle and exempt from primary liability; however, that principle is not reflected clearly in the draft Directive. For example, it is uncertain whether back-to-back transactions conducted by a financial institution as “riskless principal” qualify for the exemption from liability under Article 10(2); indeed, it is also unclear whether a CCP should be treated as a “financial institution” for the purposes of the FTT at all. Although the core activities of CCPs, securities depositaries *et al.* are exempted from

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primary liability, it is not clear whether a financial transaction involving a CCP located in one of the 11 participating Member States ("PMS") may incur liability under the "deemed establishment" provisions. This uncertainty is particularly material in view of the increased volumes of financial transactions which will require central clearing in the EU under EMIR.

The scope of the exemption for "primary market transactions" may not include certain types of transaction which would be primary market activities protected by the Capital Duties Directive (*e.g.*, the issuance of commercial paper or units in UCITS). This may result not only in legal uncertainty for issuers but also possible future legal challenges to the FTT, once implemented by the PMS.

Finally, further specific clarification is required in certain areas—for example, the basis upon which redemptions (including early redemptions) of shares, bonds, units in UCITS and other financial instruments are chargeable to FTT and how the "issuance" principle may be applied in the case of derivatives (particularly OTC derivatives).

Persons liable for the FTT, the manner of collection and enforcement

The provisions regarding the persons liable for, and the collection and enforcement of, the FTT raise various points of general and specific uncertainty.

In particular, both the legal basis and also the mechanism for effective collection and enforcement of the FTT outside the PMS—and, *a fortiori*, outside the EU—remain unclear. Provisions in this regard are to be implemented by the PMS in the first instance under the draft Directive; however, the FMLC would suggest that legal certainty might best be achieved by harmonising such provisions from the outset, as far as possible.

The application of the definition of a financial institution to various types of entity (*e.g.*, AIFMs, managers of UCITS *etc.*) requires further clarification. In particular, it is unclear how the test comparing an entity's "average annual value" of financial transactions with its "average net annual turnover" is to be calculated. If the principal value of an issuance of securities is to be taken into account, this could result in many non-financial issuers and also holding or treasury companies being treated as financial institutions.

Further guidance is also required regarding the criteria to be taken into account in applying the "economic substance" exemption under Article 4(3). The scope of this exemption is important in view of the extension of the deemed establishment provisions in the draft Directive, which appear to apply to a financial institution authorised to operate in a PMS by virtue of having "passported" its authorisation under one or more of the EU financial services directives.

Application of the anti-avoidance provisions

The anti-evasion and anti-abuse provisions in Articles 12 to 14 are uncertain in their scope and also raise various operational uncertainties.

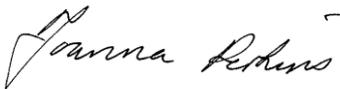
Guidance and clarification regarding the implementation of these provisions by the PMS—as well as their application to common types of market transaction—would increase legal certainty. Given that one of the stated aims of the FTT is to encourage market participants to alter their behaviour and to undertake different types of transaction (*e.g.*, secured lending), it would be particularly helpful to delineate the scope of the terms "artificial" and "commercial substance". It is also unclear which tax authority or authorities will be responsible for determining these—and related—concepts (and whether there will be any appeal procedure).

The "essential purpose" tests under Articles 13 and 14 may also result in legal uncertainty, particularly where the individual purpose of a party to a financial transaction is entirely commercial. For example, an investor might acquire a security with no knowledge that another party's (*e.g.*, the issuer's) actions have triggered the anti-avoidance provisions, thereby becoming jointly and severally liable to tax. As regards depositary receipts, it is unclear how—and by whom—the question of whether trade in such receipts has replaced trade in the underlying security to a "significant extent" is to be determined, for the purposes of Article 14(3).

Finally, in the absence of harmonising provisions, it is unclear how it will be ensured that measures adopted by the PMS to prevent tax fraud and evasion under Article 12 will interact coherently with the other anti-evasion and anti-abuse provisions.

I and Members of the Committee would be delighted to meet with you to discuss the issues raised in this letter. Please do not hesitate to contact me to arrange such a meeting or should you require further information or assistance.

Yours sincerely,



Joanna Perkins
FMLC Director