EUROPEAN STRUCTURED INVESTMENT PRODUCTS ASSOCIATION

EUSIPA (aisbl-ivzw)
Bastion Tower Level 20
Place du Champ de Mars 5
B-1050 Brussels
Belgium

Phone +32 (0) 2 550 34 15
Mail secretariat@eusipa.org
Web www.eusipa.org

Permanent Representation of Greece to the EU
c/o Mrs. Evgenia Kokolia
Rue Jacques de Lalaing 19-21
B-1040 BRUSSELS

PER MAIL

Brussels, 05 February 2014

Introduction of an EU Financial Transaction Tax (proposed directive COM 2013/71 in its amended version of January 2014) – comments

Dear Mrs. Kokolia,

EUSIPA would like to take the opportunity to comment on the above directive proposal (hereunder named "*proposed directive*") from the point of view of the structured products industry.

EUSIPA stands for European Structured Investment Products Association and represents the issuers of note-based and listed Structured Investment Products to retail customers. Our members are national industry associations from Austria, France, Germany, Italy, Sweden, Switzerland, The Netherlands and, as associated member, the relevant trade body (UK SPA) from the UK. Members of these national associations are major banking institutions. The product landscape in the EU's main markets Germany and Switzerland alone provides for a combined volume (called open interest) of around 247b Euro (Q1 2013).

With regard to the *proposed directive*, it seems that its consequences on the financial markets of the participating countries and on the financing of their economies have been blatantly underestimated. There are thus a number of critical aspects that hint to the need for further debate, some of which are currently already part of the public discussion on a broader basis. Whilst we do not intend to repeat those comments we nonetheless wish to underline some aspects that deserve attention as they point, in our eyes, to more fundamental problems:

1. Economic aspects

- The basis of many reflections about introducing an FTT is the assumption that the financial services sector is being under-taxed from a VAT point of view. This however is simply wrong. Though most of the services in the financial sector are exonerated from VAT, the exemptions were made not to disburden the financial institution but the recipient of its services. Consequently, input VAT cannot be recovered by the financial institution but becomes an indirect burden for it and forms part of the overall cost basis of financial services. A study published in 2011 by consulting group *PWC* shows that these costs

President
Reinhard Bellet

Vice-President
Roger Studer

Board of Directors
Walther Almquist
Thibault Gobert
Jan Erftemeijer
Dr Hartmut Knüppel
Dario Savoia
Jürg Stähelin
Frank Weingarts
Secretary General
Thomas Wulf

Bank Account
ING Belgium
IBAN: BE 53 310177409753
BIC: BBRUBEBB

International Non-Profit Association
(Association Internationale Sans But Lucratif)
R.L.E. (Brussels): 0806.241.432

amount to about € 33 billion, on an annual basis, for on the financial sector in the EU.

- Any FTT introduced at the level of a selected group of members would naturally deepen the economic disparities across financial markets, in particular with the US, Switzerland and Asian markets, leaving aside disparities with EU members standing aside of the project, most prominently the UK.

- Any reliance on the so-called 'residence principle' would create unbearable competitive biases, as the same instrument would not be subject to the same tax regime depending on the location of the counterparty.

- An FTT levied on the trading of derivative instruments would make hedging transactions, which form part of many financial services also provided to what usually is called "the real economy", more costly. The impacts however would ultimately be borne by final customers, investors or hedge buyers, unless they decide to trade outside the FTT zone.

- Finally, any FTT would reinforce the impact of market volatility.

2. Technical and legal comments

- A specific problem in taxing derivatives is linked to the number of transactions counted in a stock exchange trade. So far, the *proposed directive* prescribes that each transaction shall be considered single, regarding both future and option trades. Summing up opening and closing steps, there would be at least 12 single taxable intervals per transaction.

  In this context it should be noted that article 10 of the *proposed directive* does not remedy this shortcoming given that market actors are not trading for the account of other financial institutions. Furthermore, a system of trading in the name of another market actor (e.g. by acting by proxy/as agent) is not workable as such system would not prevent the risk of financial distress.

  Such difficulties could be managed by implementing the solution taken by the French legislator (in article 235, ter ZD, sec. VI Code Général d'Impôts): only the financial institution which receives the order by the final retail customer is liable to the tax (rather than any other market participant, including the customer).

- As set out below the concept of taxing "normal" financial instruments and derivatives differently runs the danger to create an incoherent taxation system. Main reason is that in financial reality there is no straightforward boundary between both groups of instruments.

- Article 2, sections 3 and 4 of the *proposed directive* is based on the definition of financial instruments as set out in annex I C of directive 2004/39/EC, which

includes derivative instruments. As derivative instruments and financial instruments other than derivatives will have both a different tax basis and different tax rates, a clear distinction between those two groups is needed for the purposes of the *proposed directive*.
The legal definitions of terms used in the *proposed directive* are based on those in other directives concerning the regulatory sector, namely the term “transferable security” in directive 2004/39/EC. Transferable securities are all instruments which have the character of **fungible instruments**. As consequence, derivative instruments which are fungible thus are transferable securities and therefore are also financial instruments in the sense of article 6 of the *proposed directive*.

Financial markets’ reality however does not allow for a clear distinction between derivative and non-derivative instruments. This lack of clarity remains in our eyes a key challenge to set out the legal basis for any taxation effort.

- The taxation of transactions handled by financial institutions in third countries is one of the most problematic issues of the *proposed directive*. One main reason is the lacking possibility to verify in many, if not the majority, of cases whether the tax outside the EU / the group of member states has been paid or not. In many jurisdictions, for example the German one, a tax where this principle of verification cannot be guaranteed is not in line with the national constitution (and could hence not be levied on national taxpayers).

  More generally, any form of taxation aiming to generate tax income from transactions outside the sovereign’s geographic boundaries stands in potential collision with the principle of territoriality, unless there is a “genuine link” between the state of taxation and the transaction occurring outside. This principle has been confirmed by several decisions of the International Court of Justice in The Hague.

  While this criteria might be met by the so-called ‘issuance principle’, as for any stamp duty, the simple conclusion of a contract concerning the trade of a financial instrument however does not sufficiently constitute such a “genuine link”. It is well known that this point of view is shared by the legal service of the Council.

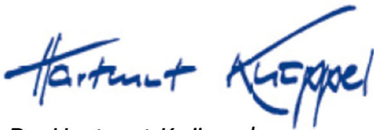
- Further major concerns finally need to be upheld with a view to directive 2008/7/EC, which (in article 5, section 2 b) expressively rules out the introduction of an indirect tax on the transaction of loans raised by the issue of debentures or other negotiable securities. Article 6, section 1 of this directive does not widen the remit because this disposal does not have any influence on **indirect** taxation. The new decision of the Belgian Constitutional Court in its case 68/2013 dated 16-05-2013 (referring to several ECJ judgments) shows that the mentioned concerns have a very real basis. The court put forward to the ECJ the question in what way the disposals under directive 2008/7/EC should be interpreted.

- With a view to article 3 number 4a of the recently released new draft proposal for an EU FTT it seems that **even securities will <u>not</u> benefit from the exoneration of primary market transactions in case they are linked to indices** (such as the many common types of floaters, certificates, profit participating bonds, inflation linked products and others). Next to fundamental concerns on taxing (such and other) securities on issuance, it should be noted that this provision **contradicts the rule put up in directive 2008/7/EG** whose recital number 9 clearly states that **no tax can be levied on the issue of a security,** (something that is as principle again repeated in article 5 section 2 of said directive 2008/7/EG).

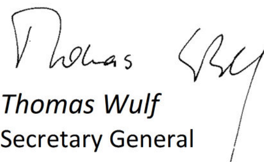
In view of these fundamental concerns we would strongly recommend to reconsider also the current draft version of the proposed directive so to avoid unintended consequences on both markets and investors.

Should this be seen as useful, we would certainly be delighted to deliver further technical reasoning on any of above mentioned items. Please do not hesitate to contact us in that case.

Sincerely,



Dr. Hartmut Knüppel
Member of the Board
EUSIPA



Thomas Wulf
Secretary General
EUSIPA