



Brussels, 31 October 2014  
(OR. en)

14949/14

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**Interinstitutional File:  
2013/0045 (CNS)**

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**FISC 181  
ECOFIN 1001**

## **REPORT**

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From:	Presidency
To:	Council
No. prev. doc.:	14576/14 FISC 168 ECOFIN 952
No. Cion doc.:	6442/13 FISC 28 ECOFIN 112 - COM(2013) 71 final
Subject:	Proposal for a Council Directive implementing enhanced cooperation in the area of Financial Transaction Tax - State of play

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### **I. INTRODUCTION**

1. On 28 September 2011, the Commission tabled a proposal for a Council Directive on a common system of financial transaction tax (FTT) and amending Directive 2008/7/EC. At the Council meetings of 22 June and 10 July 2012 and at the European Council meeting on 28/29 June 2012, it was ascertained that essential differences in opinion remained as regards the need to establish a common system of FTT at EU level and that the proposal would have not received unanimous support within the Council in the foreseeable future.

2. On the basis of the request of eleven Member States (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain), the Commission submitted a proposal to the Council for authorizing enhanced cooperation in the area of financial transaction tax. The European Commission made a proposal for the implementation of the Financial Transaction Tax under enhanced cooperation on 14 February 2013. The proposed Directive mirrored scope and objectives of the original FTT proposal put forward by the Commission in September 2011 and concerned the implementation of the enhanced cooperation in the area of FTT, in accordance with the authorization of the Council of 22 January 2013, issued following the European Parliament's consent given on 12 December 2012.
3. Since then, the proposal has been discussed by the competent Working Party of the Council.
4. At the ECOFIN Council Meeting of 6 May 2014, the Ministers of ten participating Member States released a Joint Statement which, essentially, contained the following commitments of these Member States:
  - a) they aim to create a harmonised taxation regime to tax financial transactions, work with non-participating Member States and finalize viable solutions by the end of 2014;
  - b) FTT should be implemented progressively, taxation of transactions in shares and some of the derivatives being the first step (at the latest by the end of 2015) and other steps are to be taken when economic impact is duly considered;
  - c) Member States that already have further-reaching national FTT would be able to maintain it.

## **II. STATE OF PLAY AND OPEN ISSUES**

5. On this basis, the Italian Presidency has continued negotiations and the Working Party on Indirect Taxation has met twice (on 15 July and on 7 October) to discuss possible solutions to the open issues.
6. Notably, participating Member States have continuously confirmed their agreement on the need to proceed with progressive implementation of the FTT, in order to assess the economic impact of this tax on the markets before broadening of its scope.
7. The Italian Presidency has therefore directed its main efforts on:
  - defining the scope of the transactions that would constitute the scope of the FTT at the first phase, and
  - seeking an agreement on the basic principle of taxation that would apply for the whole structure of the FTT.
8. While measurable progress has been made towards convergence of views of the Member States on the scope of the FTT, the scope of derivatives as well as the taxation principle remain a key open issue, which block the Presidency from presenting a compromise text that would lead to an agreement (see Part III of this report).

a) *taxation of transactions in shares and relevant tax exemptions*

9. At experts' level, with regard to shares, the categories of financial products to fall within the scope of taxable transactions have been identified and defined, while some technical fine-tuning remains to be done.
10. Moreover, a number of participating Member States have requested flexibility to exempt from FTT the transactions in shares of smaller companies. Seeking to address this concern, as well as taking into account the existing size differences between domestic markets, while providing for an appropriate level of harmonization, the Presidency has proposed the following solution, which is acceptable to most delegations:

Member States would be permitted to exempt transactions in listed shares with an aggregate market capitalization lower than a certain percentage of the total market capitalization of the Member State in question, as of a date close to the previous year-end.

11. A number of participating Member States prefer not to tax transactions in shares of non-listed companies. To address this concern, the Presidency is of the view that the best possible solution could be as follows:

Member States could opt to tax non-listed shares of their companies. A common method of taxation of transactions in non-listed shares would be within the framework of the Directive, in accordance with the method applied for transactions in listed shares.

### III. KEY OPEN ISSUES

**12. The key outstanding issues, which must be solved if the objectives and deadlines set out in the Joint Statement are to be met, remain the following:**

a) *taxation of transactions in derivatives*

13. Given that taxation of some derivatives is one of the commitments set out in the Joint Statement referred to above, the Italian Presidency has focused on identifying the categories of derivatives the transactions in which would constitute the “first step” of the FTT.
14. To improve the common understanding on the features of the different categories of derivatives and the potential economic impact of their taxation, the Presidency has also invited technical experts of the European Central Bank to illustrate the potential issues arising from taxation of various categories of derivatives in terms of effects on monetary policy and financial markets.
15. Most participating Member States are in favour of taxing, as a first step of the FTT implementation, transactions in derivatives which are based on the underlying that fall under the scope of the FTT (i.e. the transactions in the underlying of which are subject to FTT - e.g. equity derivatives - where transactions in that equity will be within the scope of the FTT). This approach should be adopted in order to prevent, as much as possible, distortion of financial markets as well as any tax avoidance which would arise, as it is relatively easy to shift trading from transactions in shares to non-taxable derivative financial instruments that would replicate them, in case derivatives are left outside the scope of FTT.

16. In addition, some Member States have concerns with regard to the taxation of interest rate derivatives, at least in the first phase of the FTT. Considering that these instruments are linked to the market of the government bonds and are also used in monetary policy measures, they would rather start with the taxation of other derivatives, and wait for a further step before taxing these ones.
17. Notably, some Member States have also expressed a preference to tax transactions in certain types of credit default swaps, and some other delegations, however, want to exempt equity derivatives.
- b) *Application of "issuance" and "residence" principles to define FTT*
18. Concerning taxation principles, whilst there is a certain degree of agreement on combining both issuance and residence principles, different views still remain on how to achieve this objective.
19. A group of participating Member States prefers the approach followed by the Commission proposal, i.e. application of the residence principle, supplemented by the issuance principle as last resort. The residence principle would be applied on the basis of the place of establishment of the parties to the taxable transaction. This group of participating Member States considers that such a system would be more appropriate to achieve the objectives of the Commission proposal, notably the purpose of ensuring a fair contribution from the financial institutions. This approach is also perceived as more even-handed in terms of revenue effects for different participating Member States, since it would be less disadvantageous (in comparison with the issuance principle) for Member States with a smaller number of issuers.

20. However, a number of other participating Member States are in favour of the application of the issuance principle: according to this principle, the tax would be levied depending on the place of the establishment of the issuer. They argue that this approach would better ensure the effective implementation of the tax, would be more straightforward in the application and collection, and avoid major risks of relocation of the financial transactions outside the FTT area compared to the residence principle, being the tax applied irrespective of where the taxable transactions occur or where the parties to those transactions are located.
21. In order to reach a compromise, the Presidency has explored the possibility to combine the application of the issuance principle with a revenue allocation mechanism to ensure a distribution of FTT revenues among participating Member States taking into consideration also other parameters (residence principle, combination of residence and issuance, or economic drivers). The result would be that the revenues collected by the participating Member States based on the issuance principle would be allocated on the basis of other parameters (residence principle, combination of residence and issuance principles, other economic parameters).
22. The Presidency has proposed three possible methods for the allocation of revenues among Participating Member States:
- two methods would complement the issuance principle (which would be the principle applied for the taxation) with elements of the residence principle (for allocating revenues amongst participating Member States);
  - the third method would combine the issuance principle (which would again be used for determining the taxation) with an economic driver (GNI; population, etc.) which would be the basis to reapportion the revenues collected amongst the 11 Member States.
23. However, delegations could not agree on the solution of revenue distribution that would be acceptable to all of them.

#### **IV. THE WAY FORWARD**

24. Following the discussions at the Committee of Permanent Representatives on 30 October 2014, the Council is invited to:
- a) take note of the progress achieved to date;
  - b) give indications on the way forward, with a view to resolving the issues set out in this report, and
  - c) mandate the Working Party on Indirect Taxation and the Committee of Permanent Representatives to finalize drafting of the compromise legislative text.
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