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NOTE

From:	Presidency
To:	Permanent Representatives Committee/Council
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Subject:	Proposal for a Council Directive implementing enhanced cooperation in the area of Financial Transaction Tax - State of play

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. The objective of the proposal was to ensure a fair contribution of the financial sector to the costs of the financial crisis, avoid fragmentation of the Single Market and create appropriate disincentives for transactions that do not enhance the efficiency of financial markets. 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 - hereafter referred to as "participating Member States"), and in accordance with the authorization of the Council of 22 January 2013, which was adopted following the European Parliament's consent given on 12 December 2012, the Commission on 14 March 2013 submitted a proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (hereafter referred to as the "Commission proposal"). This Commission proposal, essentially, mirrored the scope and objectives of the original FTT proposal put forward by the Commission in 2011.

II. STATE OF PLAY

3. Following the preparatory work by the Working Party on Tax Questions (WPTQ), the state of play on this dossier has been discussed at the ECOFIN Council meeting of 6 May 2014, where the Ministers of ten participating Member States released a Joint Statement.¹ Further on, the state of play on this file was discussed at the ECOFIN Council of 7 November 2014², and the Presidency also reported to ECOFIN Council which met on 9 December 2014³. Since then, throughout 2015, the WPTQ discussed the constitutive parts (the “building blocks”) of the FTT and the assembly of those “building blocks” into possible FTT models.
4. Building on the work done by previous Presidencies, the Luxembourg Presidency has enabled the continuation of deliberations among all Member States.

¹ See doc. 9399/14 FISC 79 ECOFIN 445 and doc. 9576/14 PV/CONS 22 ECOFIN460.

² See doc. 14949/14 FISC 181 ECOFIN 1001.

³ See doc. 16498/14 FISC 222 ECOFIN 1159 and doc. 16753/14 FISC 230 ECOFIN 1188 CO EUR-PREP 50, points 36 to 46.

5. During the term of the Luxembourg Presidency, two WPTQ meetings on FTT took place, where a number of issues were discussed, and in particular:
- i) some of the "building blocks" of the FTT;
 - ii) different options on how to avoid potential negative impacts of a FTT on:
 - the retirement schemes (pension plans, funds, and other products serving similar objective), and
 - the part of the economy that is concerned with producing, distributing and consuming goods and non-financial services (i.e. the "real economy").
6. The state of play of those discussions and the remaining open key issues are summarised in this note and are submitted by the Presidency for the ECOFIN Council through the Committee of Permanent Representatives.

III. KEY OPEN ISSUES

a) Application of "issuance" and "residence" principles and the scope of the FTT

7. The issue on whether and how the "issuance" and "residence" principles could be combined in defining the scope of the future FTT has already been subject of an extensive exchange of views at the Council.⁴

⁴ See doc. 14949/14 FISC 181 ECOFIN 1001 points 18 to 23.

8. During its meeting on 25 November 2015 the WPTQ discussed whether ,for transactions in derivatives, the scope of the FTT under enhanced co-operation could follow the Commission proposal, while the scope of the FTT for the transactions in shares could be limited to shares that are issued in the participating Member States only. The option for participating Member States to go further with regard to the transactions in shares in their national law was also discussed.. However, it was equally stressed that the design of the future FTT should not lead away from the key objectives underlying this legislative proposal and especially should not create a fragmentation of the Single Market.
9. A number of non-participating Member States have indicated that on this point, as well as on many other elements of the future FTT, the future agreement should not go against the interests of the non-participating Member States.
- b) *Taxable event for securities: "gross" or "net" transactions (Article 2(2) of the Commission proposal)*
10. On the issue how the taxable event for transactions in securities could be defined to determine the taxable amount, two main options have been discussed:
- i) whether FTT liability should be calculated after netting and settlement (having regard to the effective change in ownership at the end of a trading day); or
 - ii) whether such liability should rather be calculated for the "gross" amount, i.e. FTT should be applied to every trading order (ordered transaction), without any reductions due to the eventual calculation of net settlement positions.
11. The Commission's legislative proposal caters for the second option and foresees that both events - purchase and sale of a financial instrument before netting or settlement would generate FTT consequences. This seems to be the preferred option for the design of the future FTT.

c) *The treatment of the transaction chain (Article 10(1) and 10(2), as well as Article 3(1) and 3(2) of the Commission proposal)*

12. A single financial transaction may engage several financial intermediaries between two final counterparties, i. e. there might be cases where a single purchase/sale operation triggered from outside the financial sector might show up as two, three or even four trades at each side of the transaction.

13. According to Article 3(1) of the Commission proposal, “the directive shall apply to all financial transactions”, which means that all transactions by all intermediaries would fall under the scope of the FTT. Nonetheless, the Commission also proposes to exempt agency relations, so that the intermediaries to a transaction chain would be taxed to the extent that the transaction is carried out on their own account and for their own profit (proprietary trading).

14. In order to further curtail potential “cascading effects” of the tax, it was proposed during the discussion in the WPTQ that clearing members, when acting as facilitators, could also be exempt from the scope of the FTT, under certain conditions (e. g. by way of modifying Article 3(2) of the Commission proposal).

d) *Possible exemption from FTT of market making activities*

15. In its proposal, the Commission did not foresee an exemption for market making activities. However, from the start of the negotiations in Council the need to include such an exemption in the future FTT was raised and extensively discussed. In its meeting on 25 November 2015 the WPTQ focused in particular on the definition of market making activities that could potentially be exempted.

16. For the purposes of financial supervision, a number of definitions of market maker or market making exist, designed specifically for the purposes of those legal acts, for example: Article 4(1) point 7 of Directive 2014/65/EU (MIFID), Article 2 point (k) of Regulation No. 236/2012 (the Short-Selling Regulation). Further on, the negotiations on the Regulation on Structural measures improving the resilience of the EU credit institutions (BSR), which is supposed to contain a definition of market making, are still ongoing⁵.
17. Should such an exemption be part of a final compromise on the FTT, a suitable and operational definition would have to be designed, which would not hinder efficient administration and collection of the FTT. In this perspective, technical solutions would have to be found on a number of issues, such as which objective criteria would be needed to distinguish market making activities that merit such an exemption, and what should be the scope of such an exemption. For example, it could be considered, whether it is technically feasible to foresee that such a specific exemption, designed solely for FTT purposes, could be narrowed down to, for example, illiquid markets. In this context as well, the issue was also raised, whether the definitions that exist for regulatory purposes in the area of financial services could suit the specifics of the future FTT, taking into account the differences of the objectives of tax and regulatory areas. It has also been stressed that any exemptions from the future FTT should be designed in a way to minimise the risks of market fragmentation or tax avoidance and not create any potential loopholes.

⁵ See Article 5(15) in the Council general approach set out in doc. 10150/15 EF 121 ECOFIN 528 CODEC 910 + COR 1.

e) *Scope of transactions in derivatives contracts to be subject to the FTT*

18. In the course of negotiations on this legislative file, a variety of options of taxing transactions in derivatives have been discussed, ranging from a narrow scope (some derivatives only, e. g. those with only equities subject to FTT as underlying), to the broadest scope possible (which could possibly presuppose lower tax rates), while taking full consideration of the impact on the real economy and the risk of relocation of the financial sector. Some non-participating Member States stated that the application of "issuance" and/or "residence" principles to the taxation of shares and derivatives should provide for a consistent solution regarding the scope of transactions in derivatives subject to the future FTT, especially with regard to how the future FTT, agreed under the enhanced co-operation, would impact the markets in the non-participating Member States.
19. The discussions at the WPTQ level also covered the issue whether or not the taxation of derivative markets could have an impact on the cost of public borrowing. In this context, it was discussed whether, besides a possible exemption for repos and reverse repos, as well as for managers of public debt and their counterparties, there should also be an exemption for transactions in derivatives directly and fully linked to public debt.

f) *The methods for calculating the tax base for derivatives contracts (Article 7 of the Commission proposal)*

20. Under the Commission proposal, the taxable amount (tax base) for financial transactions related to derivative contracts would be the notional amount, referred to in the derivatives contract at the time of the financial transaction that falls under FTT.

21. The discussion at the Working Party level showed that further work on this issue is still required and, while, in some cases, adjustments to the tax rates or to the definition of the tax base might be necessary in order to avoid distortions, the following principles for a technical solution could be considered:
- i) for option-type derivatives: tax base could be built on the basis of option premium;
 - ii) for products other than option– type derivatives:
 - with a maturity: a term-adjusted notional amount / market value (where available) might be considered as the appropriate tax base;
 - without maturity: the notional amount/market value (where available) might be considered as the appropriate tax base.

IV. THE WAY FORWARD

22. In addition to the issues set out above, work will have to continue on a number of other open questions that constitute the “building blocks” of the design of the future FTT. This work will have to cover all remaining aspects of the Commission proposal on FTT, and in particular whether the final compromise should include specific provisions or exemptions to address concerns relating to the potential impact of the future FTT on the real economy and retirement schemes (pension plans, funds, and other products serving similar objective).
23. Against this background, the Committee of Permanent Representatives is invited to suggest that the ECOFIN Council at its forthcoming meeting:
- a) takes note of the progress achieved to date; and
 - b) exchanges views on the state of play on this dossier.