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**THE INTRODUCTION OF A FINANCIAL TRANSACTION TAX:
BELGIAN, EUROPEAN AND INTERNATIONAL INITIATIVES.**

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'Master in de rechten'

Ingediend door

Wouter Van Der Veken

(studentennr. 00903449)

Promotor: prof. dr. Michel Tison

Commissaris: Jan Loosen

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Master's thesis in the
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Supervisor: prof. dr. Michel Tison

Commissioner: Jan Loosen

PREFACE AND ACKNOWLEDGEMENTS

Being drawn to the often (mildly) esoteric area of banking, financial and capital markets law and blessed with a healthy interest in tax law, the financial transaction tax seemed like (and proved to be) an exciting and challenging multidisciplinary subject matter for a master's thesis. I could not truly foresee, however, how far the research would lead me into the realms of EU law and, to a lesser extent, international law.

Writing a thesis on a topic as politically polarized as financial transaction taxes obviously entails some pitfalls. In an informational environment dominated by political and interest groups, it is difficult to catch sight of any nuance. Even doctrinal texts and legal analyses are often the product of enthusiastic advocacy or fierce opposition. This is not necessarily detrimental to quality and insight, but it does make an impartial analysis somewhat more demanding. Nevertheless, I have tried to stick to the facts and reference all views. Throughout the legal analysis, I have attempted to stay true to the CJEU's approach as evidenced by practice, rather than following strict theoretical concepts and patterns. The latter would ever too often lead to premature conclusions.

Time will tell whether this thesis was written on the eve of the world's first supranational and broad-based FTT, to be transposed in 11 countries of the EU. Some accounts report evolutions in the negotiations towards a less broad FTT in an initial phase. The research for this thesis was based on the Commission's proposal as it currently stands. Possible changes in the near future, however, are likely and, due to their uncertain nature, could not be factored in.

I would like to express my sincere gratitude to professor dr. Michel Tison, without whose forthright remarks and questions, not seldom urging me to go back to the essence, I would have been lost in the complexity of the financial sector and EU law. I would also like to thank some other people who were essential for the completion of this thesis. In particular, I would like to thank Lynn, my parents, grandparents, family and close friends for their kind understanding and moral support.

Aalst and Hamburg

6 May 2014,

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TABLE OF CONTENTS

PREFACE AND ACKNOWLEDGEMENTS.....	IV
TABLE OF CONTENTS	V
LIST OF ABBREVIATIONS USED	VIII
INTRODUCTION, SCOPE AND OBJECTIVES	1
FIRST PART - BELGIAN, EUROPEAN AND INTERNATIONAL INITIATIVES: HOW THEY PROVIDE GUIDANCE IN FUTURE TAX DESIGN.....	3
I THE EMERGENCE OF THE FINANCIAL TRANSACTION TAX	3
1 The FTT as a steering tax	3
2 FTTs in practice: pre-crisis FTTs	5
3 FTTs in practice: post-crisis FTTs	6
3.1 National initiatives.....	6
3.2 A European FTT?.....	7
4 Overview of selected FTTs	8
II RELEVANT FACTORS FOR THE EVALUATION OF POLICY OBJECTIVES AND EFFECTS	11
1 FTTs and the standoff between market efficiency and Keynesian economics.....	12
2 FTTs as revenue-raising taxes	13
3 Possible adverse effects.....	14
4 Are FTTs easily avoided?.....	15
5 Conclusion: importance of balanced tax design in achieving the social optimum.....	16
III COMPARATIVE ANALYSIS OF TAX DESIGN.....	16
1 Methodology and rationale.....	16
2 Comparative analysis: overview of design options and selected issues	16
2.1 Taxable event	16
2.1.1 Chargeable transaction	17
2.1.1.1 Object of the transaction: equity and debt securities, currencies and/or derivatives	17
2.1.1.2 On- and/or off-exchange traded instruments	22
2.1.1.3 High-frequency trading	23
2.1.1.4 Primary market operations and restructuring	23
2.1.1.5 Exemptions for certain instruments.....	25
2.1.1.6 Exemptions for certain transactions	27
2.1.1.7 "Transactions": moment of chargeability	28

2.1.1.8	Conclusion.....	30
2.1.2	Taxable Person	31
2.1.2.1	General FTT or aimed at financial institutions.....	31
2.1.2.2	Transaction party	32
2.1.2.3	Exemptions.....	33
2.1.2.4	Intermediary relief and relief for central counterparties.....	34
2.1.2.5	Transactions within groups.....	38
2.1.2.6	Conclusion.....	39
2.1.3	Territorial scope.....	40
2.1.3.1	Connecting factors: general	40
2.1.3.2	EU 11 FTT territorial scope: establishment, contagion effect and economic substance defence	46
2.1.3.3	Conclusion.....	47
2.2	Tax base.....	47
2.2.1	Which amount?.....	48
2.2.2	Netted amount at settlement	51
2.3	Tax rate.....	51
2.3.1	General	51
2.3.2	High speculation-aimed rate.....	54
2.4	Conclusion: tax base and rate	54
2.5	Tax collection and enforcement	55
2.5.1	Importance of financial market infrastructure and regulation	55
2.5.2	Person liable to pay	58
2.5.2.1	FMI and intermediaries as collecting agents.....	58
2.5.2.2	Joint and several liability of other parties.....	60
2.5.2.3	Examples	60
2.5.2.4	Special case: foreign exchange.....	62
2.5.3	Reporting, tax assessment and information rights.....	63
2.5.4	Frequency of and term for payment	65
2.5.5	Penalties and/or interest.....	66
2.5.6	Special penalty: legal standing	67
2.5.7	Anti-avoidance provisions.....	68
2.5.8	Tax enforcement on transactions abroad and mutual assistance	68
2.5.9	Conclusion.....	69

IV	ALTERNATIVES FOR THE INTRODUCTION OF A FINANCIAL TRANSACTION TAX	70
1	Bank levy.....	70
2	FAT	71
3	The "right" tax	72
SECOND PART - THE LEGALITY OF A TAX ON FINANCIAL TRANSACTIONS IN THE EUROPEAN UNION ..		73
I	CUSTOMARY INTERNATIONAL LAW: TAX JURISDICTION	73
1	The legal relevance of customary international law in the European institutional order	73
2	International jurisdiction	73
3	The legality of FTT's territorial scope	74
3.1	Traditional connecting factors	74
3.2	EU 11 FTT.....	75
II	EUROPEAN UNION LAW	77
1	Treaty Freedoms.....	77
1.1	Capital Duty Directive or primary EU law?.....	77
1.2	Starting point: the concept of taxing financial transactions.....	78
1.2.1	Applicable Treaty freedom.....	78
1.2.2	Discrimination	80
1.2.3	Restriction.....	80
1.2.4	Disproportionate relation between tax amount and transaction value: the case of the EU 11 FTT.....	82
1.2.5	Justification.....	85
1.2.5.1	Low-margin speculative trading	85
1.2.5.2	Other low-margin market practices	87
1.3	FTTs with specific features	89
1.3.1	Spot foreign exchange and derivatives	89
1.3.2	EU 11 FTT: 'Contagion' effect and joint and several liability	93
2	Article 113 TFEU and the EU 11 FTT	95
3	Legality of national FTTs in participating Member States if EU 11 FTT is adopted	98
4	Issues in FTT design in relation with the Capital Duty Directive	98
CONCLUDING REMARKS		100
INDEX OF TABLES AND FIGURES		103
BIBLIOGRAPHY		104
NEDERLANDSE SAMENVATTING VAN DE MASTERPROEF CONFORM ARTIKEL 3.2.3 VAN HET REGLEMENT MASTERPROEF.....		120

LIST OF ABBREVIATIONS USED

ADR	American Depositary Receipt
AIF	Alternative Investment Fund
BIS	Bank for International Settlements
CCP	Central counterparty
CDD	Capital Duty Directive
CDS	Credit default swap
CFD	Contract for difference
CJEU	Court of Justice of the European Union
CLAT	Civil Law Activity Tax (Poland)
CRD	Capital Requirements Directive
CSD	Central Securities Depository
CTT	Currency transaction tax
DNS	Deferred net settlement
EC	European Commission
ECB	European Central Bank
EFSF	European Financial Stability Facility
EMIR	European Market Infrastructure Regulation
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
FTT	Financial transaction tax
FX	Foreign exchange
HFT	High-frequency trading
HMRC	Her Majesty's Revenue and Customs
ICMA	International Capital Market Association
IMF	International Monetary Fund
IOF	<i>Imposto sobre Operações Financeiras</i> (Brazil)
IRS	Interest rate swap
ISP	Investment service provider
LSE	London Stock Exchange
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MTF	Multilateral Trading Facility
NYSE	New York Stock Exchange
OTC	Over-the-counter
OTF	Organised Trading Facility
PCIJ	Permanent Court of International Justice
RTGS	Real-time gross settlement
SDRT	Stamp Duty Reserve Tax (UK)
SFT	Securities financing transaction
STT	Securities transaction/transfer tax
SSR	Short Selling Regulation
SSS	Securities Settlement System
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UCITS	Undertakings for the Collective Investment of Transferable Securities
VAT	Value-added tax

INTRODUCTION, SCOPE AND OBJECTIVES

1. The call for taxation of the financial sector has never been louder than in the wake of the recent financial crisis, owing to taxpayer funded bail outs. Simultaneously, policy makers across the globe exhibit an unrivalled industriousness in (re-)regulating the financial sector. It is not surprising that the financial transaction tax ("FTT"), a measure seemingly effective in both fields, has gained political support. Several countries have (re)introduced taxes on financial transactions or are planning to do so. Moreover, 11 European Member States are currently in the process of adopting a financial transaction tax under the procedure of enhanced cooperation after previous initiatives on G-20 and EU-wide level have failed to reach a consensus.

2. "Financial transaction" is an opaque and poorly delineated concept. All types of contracts somehow connected to financial institutions, instruments and markets could qualify. A workable definition is therefore necessary. A financial transaction tax, for the purposes of this thesis, is a gross transaction tax on (i) transactions involving financial instruments and, more precisely, (a) the transfer of securities and similar financial instruments (e.g. units in collective investment undertakings), and (b) the conclusion and/or transfer of financial derivatives contracts, and (ii) the transfer of currencies.

3. FTT is a transaction tax. This implies that it is an indirect tax on single transactions, comparable with value-added tax ("VAT"). In this regard, FTT is to be distinguished from taxation of financial instruments under direct taxes (e.g. taxation of capital gains on shares under income tax) or taxes on balance sheet positions of financial institutions (e.g. bank levies, see no. 142). Moreover, FTT is a gross transaction tax, which means that it is imposed on the full value of a single transaction and not on, for instance, added value or net profit.¹

4. The IMF distinguishes several types of financial transaction taxes of which two fit the present definition: the securities transaction tax ("STT"), *i.e.* a tax on trades in all or certain types of securities (equity or debt) and their derivatives, and the currency transaction tax ("CTT"), *i.e.* a tax on foreign exchange transactions and, possibly, their derivatives.² Accordingly, a third type, not put forward by the IMF, is within scope: a tax on financial derivatives, other than those already in scope of STTs or CTTs (e.g. commodities derivatives). Other tax types are outside the scope of this thesis. Capital levies are charges on the raising of capital, *i.e. inter alia* capital contributions, certain loans and the issuance

¹ In the EU, VAT is also levied as a gross tax in first instance. Taxable persons, however, are able to recoup VAT paid on services and goods purchased, leaving only the added value taxed.

² IMF, "Financial Sector Taxation: the IMF's Report to the G-20 and Background Material", September 2010, 145-146, www.imf.org/external/np/seminars/eng/2010/paris/pdf/090110.pdf (hereafter: IMF, "Financial Sector Taxation").

of securities. Capital levies will, however, be dealt with laterally, *viz.* insofar as they coincide with STTs or when STTs have capital levy components. Other out of scope taxes include bank transaction taxes (e.g. on deposits, payments, loans, etc.), insurance premium taxes and real estate taxes that incidentally tax the transfer of shares in real estate holding companies.³

5. The definition of financial transaction taxes developed above provides a firm starting point for further inquiries, without being too rigid. Several elements still require some interpretation (e.g. "financial derivatives") or warrant a flexible approach (e.g. "tax" will be interpreted broadly as encompassing certain levies and non-tax charges).⁴ In addition, it should be noted that a substantial number of national tax schemes incorporate elements of several taxes discussed above. For those schemes, this thesis will focus on the FTT component. This definition of FTT is similar to the one used by the European Commission.⁵

6. The aim of this thesis is twofold. Firstly, it sets out to identify relevant legal and practical issues in tax design (first part). Secondly, it assesses certain issues concerning the legality of FTTs in general and certain design features in particular (second part). The first part commences with a brief description of the historical emergence of FTTs, which is pivotal in understanding their objectives (I). In addition, an overview of existing national initiatives is given. Next, the factors relevant to an assessment of economic effectiveness and efficiency are examined (II). The bulk of the first part, however, is a comparative analysis of the tax design of existing and historical FTTs (III). Elements from I and II, *i.e.* FTT objectives, the body of national initiatives and the economic "endpoints" are conceived as necessary prerequisites and a framework for an in-depth comparative exercise. Once the strengths and weaknesses of FTTs are unveiled, the question arises whether alternatives exist which could equally or more successfully achieve their objectives (IV). The second part of the thesis deals with legal issues raised in the past, as well as more recently: the compatibility of extraterritorial FTTs with customary international law (I) and the legality of FTTs and their features in light of several elements of EU law, most notably the free movement of capital and EU competences (II).

³ IMF, Financial Sector Taxation, *supra* footnote 2, 145-146.

⁴ E.g.: the "Section 31" fees levied for the operation of the US SEC (see Table I).

⁵ See EC, "Impact Assessment accompanying the document Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC", COM(2011) 594 final, Annex 7, 1, http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/ftt_background_en.htm (hereafter: EC, "Impact Assessment EU FTT").

FIRST PART - BELGIAN, EUROPEAN AND INTERNATIONAL INITIATIVES: HOW THEY PROVIDE GUIDANCE IN FUTURE TAX DESIGN

I THE EMERGENCE OF THE FINANCIAL TRANSACTION TAX

1 The FTT as a steering tax

7. John Maynard KEYNES was the first to propose the introduction of a steering STT as early as 1936. In his view, speculation did not contribute to Wall Street's proper social purpose, namely to "direct new investment into the most profitable channels in terms of future yield."⁶ KEYNES argued that short-term speculation, *i.e.* attempting to forecast market psychology, can push asset prices far beyond fundamental values, thereby creating asset bubbles. He proposed the introduction of a transfer tax on all stock market transactions to curb speculation. KEYNES thereby became the first proponent of STTs. At the same time, he developed the main two-folded postulate upon which the economic case for FTTs rests: (i) short-term speculation creates asset price bubbles and (ii) raising transaction costs under the form of transaction taxes reduces this speculative activity.

8. From the years after World War II until the end of the 1960s, currency exchange rates were relatively stable due to one particular feature of the Bretton Woods system: the concept of fixed exchange rates.⁷ Central banks intervened in the foreign exchange market to keep their currency's exchange rate within a small band from its pegged rate (*i.e.* a fixed rate determined in relation to USD). The value of USD, in turn, was connected to that of gold. After the collapse of the system, exchange rates of all major currencies were allowed to float relatively free. In response to the gradual breakdown of the Bretton Woods system, American economist and Nobel Prize laureate James TOBIN introduced his concept of taxing spot foreign exchange ("FX") transactions with a small charge.⁸ The main purpose of the Tobin tax (as it is commonly denominated) is to bring the currency markets closer to economic fundamentals. The rationale of KEYNES' proposal is clearly discernible. FX speculators mainly act with short-term goals and drive exchange rates away from their value based on underlying fundamental information. Financial markets operate significantly faster than the real economy. Since the best solution, *i.e.* creating a single world currency, was (and is) not very realistic, TOBIN proposes

⁶ J.M. KEYNES, *The General Theory of Employment, Interest and Money*, New Delhi, Atlantic, 2008, 142-143 (hereafter: J.M. KEYNES, *General Theory*). The first version was published in 1936.

⁷ See IMF, "Cooperation and reconstruction (1944-71)", www.imf.org/external/about/histcoop.htm; G.G.B. BROW, "The Tobin Tax: Turning Soros into Plowshares?", *Transnational Law & Contemporary Problems* 1999, 349-353 (hereafter: G.G.B. BROW, "Tobin Tax").

⁸ See J. TOBIN, "A Proposal for International Monetary Reform", *Eastern Economic Journal* 1978, 153-159 (hereafter: J. TOBIN, "A Proposal").

to "put sand in the wheels of our excessively efficient international money markets".⁹ The proverbial sand comes in the form of a low rate transaction tax on spot foreign exchange transactions, which, according to TOBIN, would be almost trivial for fundamental investors or cross-border economic operators in need of foreign currencies, but prohibitively high for short-term speculators. KEYNES' and TOBIN's FTTs are thus not interested in raising revenue, but aimed at behaviour creating negative externalities. TOBIN described his first proposal as falling "like a stone in a deep well".¹⁰ Foreign exchange market turnover has increased exponentially since 1980. The adoption of CTTs, however, has remained the exception.

9. Several currency crises in the 1990s sparked the general interest for TOBIN's proposal made two decades before.¹¹ As is often the case, speculators were blamed by policymakers. The Tobin Tax now received wide academic and political interest. Some scholars, while being sympathetic to the general assumption underlying CTTs, identified weaknesses in TOBIN's original proposal and set out to devise their own refined versions. In the latter category, the most well-known proposals were made by SPAHN in 1995 and SCHMIDT in 1999, which will be touched upon elsewhere.¹² Some national parliaments took steps towards the implementation of a CTT, among them Canada and France.¹³ Belgium went furthest, adopting legislation for the introduction of a CTT.¹⁴ The law, however, never came into force and is therefore rather symbolical. The Belgian CTT was criticized heavily by EU institutions, not in the least by the ECB.¹⁵

10. The recent financial crisis has brought the debate to a whole new level. The idea of adopting a broad tax on several types of financial transactions, rather than a Tobin Tax on foreign exchange, is gaining political ground. Traditional views on the efficiency of financial markets have lost a part of the

⁹ J. TOBIN, "A Proposal", see *supra* note 8, 154.

¹⁰ J. TOBIN, "A Proposal", see *supra* note 8, 155.

¹¹ Examples are the European Exchange Rate Mechanism (ERM) crisis (1992-1993), the Mexican Peso crisis (1994), currency crises in Asia (1997). See G.G.B. BROW, "Tobin Tax", see *supra* note 7, 368-375.

¹² P.B. SPAHN, "International Financial Flows and Transactions Taxes: Survey and Options", IMF Working Paper, June 1995, 58 p., http://papers.ssrn.com/sol3/papers.cfm?abstract_id=883208 (hereafter: P.B. SPAHN, "Transactions Taxes"); R. SCHMIDT, "A Feasible Foreign Exchange Transactions Tax", North-South Institute, March 1999, 23 p., www.ideaswebsite.org/pdfs/tobin_tax.pdf (hereafter: R. SCHMIDT, "Foreign Exchange Transactions Tax").

¹³ House of Commons (Canada), "House of Commons Debates Official Report", 23 March 1999, 13323 *et seq.*, www.parl.gc.ca/content/hoc/House/361/Debates/202/han202-e.pdf: the Canadian House of Commons instructed the government to enact a CTT, which never happened. H. PATOMÄKI, "Global Tax Initiatives: The Movement for the Currency Transaction Tax", UN Research Institute for Social Development, 2007, 6, [www.unrisd.org/80256B3C005BCCF9/\(httpAuxPages\)/5F5FC3415E8C94B0C125726B005725E0/\\$file/patoma_k2.pdf](http://www.unrisd.org/80256B3C005BCCF9/(httpAuxPages)/5F5FC3415E8C94B0C125726B005725E0/$file/patoma_k2.pdf).

¹⁴ Wet tot invoering van een heffing op omwisselingen van deviezen, bankbiljetten en munten, Belgian Official Gazette 24 December 2004, 85760 *et seq.* (hereafter: Law on foreign exchange taxation).

¹⁵ ECB, "Opinion of the European Central Bank at the request of the Belgian Ministry of Finance on a draft law introducing a tax on exchange operations involving foreign exchange, banknotes and currency", 4 November 2004, 4-5, https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2004_34_f_sign.pdf (hereafter: ECB, "Opinion tax on foreign exchange").

credibility they had enjoyed among politicians and academics. "Notorious" critics of the market's effectiveness in reflecting fundamental equilibria gained support. In the words of KRUGMAN: "[...] a financial transactions tax is an idea whose time has come".¹⁶ This post-crisis environment has led to several national and supranational initiatives (see no. 14-16).

2 FTTs in practice: pre-crisis FTTs

11. The concept of taxing financial transactions and, more precisely, transfers of securities is far from new. Securities transfers have been chargeable to stamp duty or securities transfer taxes in numerous jurisdictions throughout the 20th century and even earlier. Many still exist today. From a technical point of view, stamp duties are charges on legal documents evidencing a certain transfer, whereas STTs in a strict sense are charges on the transaction itself.¹⁷ Stamp tax is usually not specifically directed at financial transactions, but often incorporates a broad varying range of legal documents in its tax base. For the present purposes, both stamp duties and securities transfer taxes *sensu stricto* will be referred to as STTs.

12. One of the most well-known stamp taxes also covering securities transactions is UK stamp duty, which was originally introduced in 1694.¹⁸ The UK government introduced a new tax with the Finance Act 1986 to cater for technological innovations on the financial markets: stamp duty reserve tax ("SDRT").¹⁹ "Paperless" (*i.e.* electronic) transfers of UK securities had been on the rise and, due to the absence of physical documents, these were not subject to stamp duty. Strictly speaking, SDRT is a STT imposed on *agreements* and not a true stamp duty. Other countries with British colonial history often have or had similar taxes. Several other continental countries operate or have operated transfer taxes, often directed at stock exchange trades, which sometimes emanate from older stamp taxes. By the end of the 1980s and beginning of the 1990s, STTs were clearly in decline.²⁰

13. These FTTs are merely revenue-raising instruments and generally have no bearing to any policy objective. Sweden, however, introduced a STT on equity and options in 1984 and later added debt. This was clearly a steering tax, inspired by the idea that a part of financial sector activity is

¹⁶ P. KRUGMAN, "Taxing the Speculators", *New York Times*, 26 November 2009, www.nytimes.com/2009/11/27/opinion/27krugman.html.

¹⁷ Stamp taxes were invented in the Netherlands in 1624: HMRC, "Stamp Taxes Manual", 2001, 12, www.hmrc.gov.uk/so/manual.pdf (hereafter: HMRC, "Stamp Taxes Manual").

¹⁸ HMRC, "Stamp Taxes Manual", see *supra* note 17, 12.

¹⁹ HMRC, "Stamp Taxes Manual", see *supra* note 17, 8-9.

²⁰ T. MATHESON, "Taxing Financial Transactions: Issues and Evidence", IMF Working Paper, March 2011, 9, www.imf.org/external/pubs/ft/wp/2011/wp1154.pdf (hereafter: T. MATHESON, "Taxing Financial Transactions").

socially wasteful.²¹ The tax's results were disappointing, which is often recalled by FTT opponents. The tax raised little revenue, led to widespread migration of trading volume to other financial centres and adversely affected trading volumes in Swedish sovereign debt.²² It has been argued that the Swedish failure is largely due to poor tax design. Likewise, proposals were made in the US, fuelled by the stock market crash in 1987.²³ Several prominent figures proposed to reintroduce a federal STT and a levy on futures was contemplated during yearly budget negotiations in the 1990s.²⁴ None of these proposals made it into law. Another example is the proposal to reinstate the New York stamp duty.²⁵ Finally, several jurisdictions in South-America have, often with clear (monetary) policy objectives, adopted broad-based taxes on several kinds of banking transactions in the end of the 1990s and the beginning of the new millennium.²⁶ Brazilian IOF is one rare example of a CTT. For an overview of historical and existing STTs and references see **Table I** further below.

3 FTTs in practice: post-crisis FTTs

3.1 National initiatives

14. After the recent crisis, a proposal for a global FTT at G-20 level failed.²⁷ Some jurisdictions, however, kept pressing for a national or regional FTT. In 2012, the Leading Group on Innovative Financing for Development presented a draft treaty for the implementation of a FTT.²⁸ Within the EU, some Member States have not awaited action on the EU level and adopted national FTTs. France adopted a FTT in 2012 and Italy in 2013.²⁹ These FTTs are still akin to traditional STTs, but nevertheless "flavoured" by the crisis (e.g. specific provisions regarding HFT and taxation of

²¹ J.Y. CAMPBELL and K.A. FROOT, "International Experiences with Securities Transaction Taxes" in J.A. FRANKEL (ed.), *The Internalization of Equity Markets*, Chicago, University of Chicago Press, 1994, 280.

²² J.D. BRONDOLO, "Taxing Financial Transactions: An Assessment of Administrative Feasibility", IMF Working Paper, August 2011, 17, www.imf.org/external/pubs/ft/wp/2011/wp11185.pdf. (hereafter: J.D. BRONDOLO, "Taxing Financial Transactions").

²³ C.S. HAKKIO, "Should we throw Sand in the Gears Of Financial Markets?", *Federal Reserve Bank of Kansas City Economic Review* 1994, 17.

²⁴ E.g.: G.W. SCHWERT and P.J. SEGUIN, "Securities Transaction Taxes: An Overview of Costs, Benefits and Unresolved Questions", *Financial Analysts Journal* 1993, 27-28.

²⁵ See R. POLLIN and J. HEINTZ, "Evaluation of a Proposal to Reinstate the New York Stock Transfer Tax", *Challenge* 2003, 71-105, www.peri.umass.edu/fileadmin/pdf/ftt/Pollin-Heintz--Financial_Transaction_Tax_for_NY_State--Challenge_7-03.pdf.

²⁶ E.g.: Argentina, Brazil, Colombia and Peru: D. BEITLER, "Raising Revenue: A review of Financial Transaction Taxes throughout the world", Report for Health Poverty Action and Stamp Out Poverty, September 2010, 22, www.healthpovertyaction.org/wp-content/uploads/downloads/2012/07/FTTreport-Raising-revenue.pdf (hereafter: D. BEITLER, "Review of Financial Transaction Taxes").

²⁷ L. WROUGHTON, "G20 fails to endorse financial transaction tax", *Reuters*, 4 November 2011, www.reuters.com/article/2011/11/04/g20-tax-idUSN1E7A302520111104.

²⁸ Leading Group, "How can we implement today a Multilateral and Multi-jurisdictional Tax on Financial Transactions", October 2011, www.leadinggroup.org/IMG/pdf/Rapport_TTF_ANG_300112_bis.pdf (hereafter: Leading Group, "Tax on Financial Transactions").

²⁹ Art. 235 ter ZD, ter ZD bis and ter ZD ter *Code général des impôts* (FR) (hereafter: CGI); L. 24 December 2012, n. 228 (IT).

derivatives). Hungarian FTT has entered into force on 31 January 2013, but is largely a bank transfer tax. It does, however, have an STT leg which has not yet entered into force.³⁰ The Portuguese government has been authorized to introduce a FTT and in Spain a proposal has been tabled.³¹ Outside the EU's borders, Ukraine adopted a FTT in 2013, but subsequently limited it to a fixed charge on certain derivative transactions.³² In the US, several bills have been introduced in Senate and Congress, but it would seem that support is (still) too limited to allow for an adoption any time soon.³³

3.2 A European FTT?

15. Initially, the EU Commission favoured other bank taxes over the FTT (see no. 145). On 28 September 2011, however, the Commission proposed a common FTT for the EU on a wide range of financial instruments (the "EU FTT Proposal").³⁴ Member States such as the UK and Sweden, however, opposed and, because the adoption of a harmonizing tax measure requires unanimity, the proposal was shelved. 11 Member States officially requested the Commission to proceed under the procedure of enhanced cooperation, allowing them to adopt a harmonized FTT within the institutional framework of the EU. Consent was given in the ECOFIN Council on 22 January 2013.³⁵ In the course of the procedure, other Member States may join. The Commission presented an amended proposal on 14 February 2013 (the "EU 11 FTT Proposal").³⁶ The EU 11 FTT was set to enter into force on 1 January 2014. However, there is no agreement yet on some critical design features. Moreover, the legal services of the various EU institutions disagree on the EU 11 FTT's conformity with EU and international law.³⁷ Recent elections in Germany have provided for new momentum and have even lead to requests for the inclusion of spot foreign exchange transactions.³⁸ The UK, who is opposing the extraterritorial features of the EU 11 FTT, has lodged an action for annulment of the authorization decision to proceed with enhanced cooperation. As expected, the CJEU dismissed the action because the legal grounds upon which the action was based were not a consequence of the authorization

³⁰ Citibank, "Hungarian Financial Transaction Tax", 4 December 2013, www.citibank.com/transactionservices/home/about_us/online_academy/docs/hungary_fin_update.pdf.

³¹ Clearstream, "Portugal: Introduction of a Financial Transaction Tax (FTT): update", 3 January 2013, www.clearstream.com/ci/dispatch/en/cic/CIC/Announcements/ICSD/Marketflashes/2013/M13001.htm; Allen & Overy, "Financial Transaction Tax: Sending shock waves through global financial services", 2013, 40, www.allenoverly.com/SiteCollectionDocuments/Global%20Tax_FTT%20Brochure%20%28email%29.pdf.

³² Deloitte, "A round-up of FTT developments across Europe", 25 November 2013, 3, www.deloittelux-library.com/FTT/uk_en_fttnewsletter_26112013.pdf.

³³ See H.R. 1068 (111th): Let Wall Street Pay for Wall Street's Bailout Act of 2009.

³⁴ Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2007/7EC, COM(2011) 549 final (hereafter: EU FTT Proposal).

³⁵ Decision Council No. 2013/52/EU, 22 January 2013 authorising enhanced cooperation in the area of financial transaction tax, *OJ. L.* 25 January 2013, 22, 1.

³⁶ Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, COM(2013) 71 final (hereafter: EU 11 FTT Proposal).

³⁷ J. FLEMING, "Council, Commission lawyers in Mexican stand-off on FTT", *EurActiv*, 5 December 2013, www.euractiv.com/euro-finance/council-commission-lawyers-mexic-news-532143.

³⁸ J. AGLIONBY, "Highlights of the German coalition agreement", *FT*, 27 November 2013, www.ft.com/intl/cms/s/0/43c76bda-573b-11e3-9624-00144feabdc0.html#axzz2zpe7tiw4.

decision as such.³⁹ This case is a clear shot across the bow, warning that an action for annulment will follow if the EU 11 FTT is adopted. In the course of the final editing of this thesis, some evolutions took place, making it likely that the EU 11 FTT will initially be adopted in a "watered down" version, operative as from 2016, with the possibility to broaden its scope later on.⁴⁰

16. The objectives of the EU FTT and EU 11 FTT are to (i) harmonize the field of FTT to ensure the proper functioning of the internal market⁴¹, (ii) ensure that financial institutions make a fair and substantial contribution to covering the costs of the crisis and level the playing field with other sectors regarding taxation, and (iii) create appropriate disincentives for transactions that do not enhance the efficiency of the financial markets, thereby complementing other regulatory reforms.⁴² These objectives show post-crises features in addition to a general budgetary aim.

4 Overview of selected FTTs

17. Sources regularly diverge on the exact number of FTTs globally and the classification of certain taxes. The taxes presented here are imposed on one or more transactions contained in the FTT definition above.

Table I - Overview of selected taxes on financial transactions

Country	Type	Remarks
Australia	State stamp duties	In 1999, the federal government and state governments reached an agreement to abolish stamp duties on listed securities and phase out stamp duties on unlisted securities. New South Wales and South Australia have deferred abolishment of the latter until their budgetary situation ameliorates.
Austria	Stock exchange tax*	Abolished in 2000.
Argentina	Federal stamp duty on share transfers*	Abolished in 2001.
Belgium	Stock Exchange Tax	Rates amended from time to time in yearly budget laws.
	Levy on transfer of bearer instruments	Complements the abolishment of bearer instruments.

³⁹ CJEU C-209/13, *United Kingdom v Council*, not yet published.

⁴⁰ A. BARKER, "Eurozone divided over financial transaction tax deal", *FT*, 6 May 2014, <http://www.ft.com/intl/cms/s/0/d8a5d630-d529-11e3-9187-00144feabdc0.html#axzz30xBE1uC9>.

⁴¹ This objective is a supporting argument for EU competence (Art. 113 TFEU): see below.

⁴² Explanatory Memorandum with the Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, COM(2013) 71 final, 2 (hereafter: Explanatory Memorandum EU 11 FTT).

	Tax on currency transactions	Not yet effective.
Brazil	Tax on Financial Operations ("IOF")	Tax on exchange of foreign currency for Real for various purposes.
China	Security transaction tax	Introduced in 1990. Levied on the Shenzhen and Shanghai markets. Taxation of bonds abolished in 2001.
Cyprus	Stamp duty	
	Stock transfer fee on sales of shares listed on the Cypriot Stock Exchange*	Abolished as from 31 December 2011.
Denmark	Stock exchange stamp duty*	Operated until 1 June 1987.
	Share transfer tax*	Replaced stamp duty. Abolished in 1999.
Finland	Transfer tax	
France	Stock exchange duty (<i>impôt de bourse</i>)*	Existed between 1893 and 2008.
	FTT	Adopted in 2012.
Germany	Stock exchange turnover tax (<i>Börsenumsatzsteuer</i>)*	Abolished in 1991.
Greece	Tax on sale of listed shares*	Introduced in 1998. Only for shares acquired up to 31 December 2012. For shares acquired as from 1 January 2013, capital gains are subject to income taxation.
Hong Kong	Stamp duty on Hong Kong Securities	Introduced in 1866.
Hungary	FTT	Currently FTT on payment services, issuing bills and accepting deposits. FTT on securities and security linked derivatives will come into force as of 1 January in the year after EU 11 FTT is adopted.
India	Security Transaction Tax	Introduced in 2004. Tax on equities, futures and options.
	Commodities Transaction Tax	Proposed tax on exchange-traded commodity futures.
	Local stamp taxes	May apply.
Ireland	Stamp Duty	
Italy	Stamp duty and registration fees*	Applied to communications made by financial intermediaries or registration of contracts in some circumstances. Repealed for contracts signed on or after 31 December 2008.

	FTT	Adopted in 2013.
Japan	Security transaction tax*	Abolished in 1999.
Malta	Stamp duty	
Netherlands	Stamp tax (<i>beurszegel</i>)*	Stamp taxes were abolished altogether in 1972.
	Transfer tax on securities*	This tax replaced stamp duty, but was repealed in 1990
New Zealand	Stamp duty*	Abolished in 1999.
Poland	Civil Law Activities Tax ("CLAT")	Tax on transfers of property rights. Only applicable when no party is subject to VAT.
Romania	Levies on securities transactions to fund operations of the Romanian Securities Commission	
Singapore	Stamp duty	Stamp duty on share transfer documents
South Africa	Stamp duty*	
	Uncertificated Securities Tax*	
	Securities Transfer Tax	Both pre-existing FTTs merged into one Securities Transfer Tax, which came into force from 1 July 2008.
South Korea	Stamp duty	Stamp duty on equity instruments.
Spain	Tax on securities transfers*	Was part of a broader tax. Abolished in 1988.
Sweden	Securities transfer tax*	Adopted in 1984. Phased out in 1990 and 1991.
Switzerland	Transfer tax on securities (<i>Umsatzabgabe</i>)	Part of a broader stamp duty which also includes a capital duty.
Taiwan	Securities transaction tax	
	Futures Transaction Tax	Imposed on several derivatives.
Ukraine	FTT	FTT on off-exchange securities and derivatives entered into force on 1 January 2013. As of 1 January 2014, FTT was abolished for equities and is now only applicable to certain derivatives.
United Kingdom	Stamp Duty	Stamp duty on equity instruments.
	Stamp Duty Reserve Tax ("SDRT")	STT on paperless transfers of equity.
United States	Federal stamp tax*	Stamp duty on the transfer of certain securities. Operative from 1914 until 1965. Abolished in wider repeal of retail and excise taxes.
	State stamp taxes on securities transfers	E.g.: New York stamp duty* was introduced in 1909. Since 1981 the tax is immediately rebated

		to the taxpayer.
	"Section 31 fees"	Small fee on the volume traded on certain exchanges, levied for the purpose of funding the US Securities Exchange Commission.
	Other historical stamp taxes*	E.g. stamp tax on "times sales" of gold (<i>i.e.</i> forward contracts) during Civil War (1863).

*: Tax abolished.

Sources⁴³

II RELEVANT FACTORS FOR THE EVALUATION OF POLICY OBJECTIVES AND EFFECTS

18. The objective of any policy should be to induce an increase of total societal welfare, *i.e.* by inducing benefits and reducing costs from a societal point of view. In reality, however, policy measures often have a myriad of beneficial and detrimental effects and it should be assessed whether positive effects offset negative ones. With relation to FTTs, positive effects are the possible reduction of harmful short-term speculative trading and the revenue collected, the latter of which is only truly positive if this funds is used more efficiently than the taxpayers would have. Positive effects may also be somewhat more ethereal, such as creating a political willingness of adopting a global FTT.⁴⁴ Negative effects include a multiplicity of repercussions with adverse impact on GDP. Debate among economists focuses on the existence of alleged positive effects and, to a lesser extent, the intensity of negative effects.

⁴³ **General:** B. LARKING, "Overview of Existing National Taxation of the Financial Sector" in O. MARRES and D. WEBER (eds.), *Taxing the Financial Sector*, Amsterdam, IBFD, 2012, 40 (hereafter: B. LARKING, "Existing National Taxation"); D. BEITLER, "Review of Financial Transaction Taxes", see *supra* note 26, 1-35; EC, "Impact Assessment Accompanying the document Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax: Analysis of policy options and impacts", 14 February 2013, Annex 3, 492 *et seq.* and Annex 9, 64-66, http://ec.europa.eu/taxation_customs/resources/documents/taxation/swd_2013_28_en.pdf (hereafter: EC, "Impact Assessment EU 11 FTT"); B. CORTEZ and T. VOGEL, "A Financial Transaction Tax for Europe?", *EC Tax Review* 2011, 22-24 (hereafter: B. CORTEZ and T. VOGEL, "Financial Transaction Tax"); Deloitte, "A round-up of FTT developments across Europe", 25 November 2013, 3, www.deloittelux-library.com/FTT/uk_en_fitnewsletter_26112013.pdf. **AU:** Ashurst, "Stamp duty: Rates and thresholds", 20 November 2013, 1, www.ashurst.com/doc.aspx?id_Content=9253. **FR:** P.-C. HAUTCOEUR (ed.), *Le marché financier français au XIX^e siècle Volume 1. Récit*, Paris, Publications de la Sorbonne, 2007, 421. **NL:** T. PFEIL, *Op Gelijke Voet: De geschiedenis van de Belastingdienst*, Deventer, Kluwer, 2009, 290-291. **SE:** J.D. BRONDLO, "Taxing Financial Transactions", see *supra* footnote 22, 17. **US:** G.W. SCHWERT and P.J. SEGUIN, "Securities Transaction Taxes: An Overview of Costs, Benefits and Unresolved Questions", *Financial Analysts Journal* 1993, 27-28.

⁴⁴ EC, "Impact Assessment EU FTT", see *supra* note 5, 38.

1 FTTs and the standoff between market efficiency and Keynesian economics

19. As noted, KEYNES believed that higher transaction costs lead to fewer speculation. The assumption therefore must be that speculation in general leads to lower profit margins per trade, while total profit may be substantial in aggregate. This may, for instance, be the case because speculative trading is often short-term. The assumption holds true for modern trading practices such as high-frequency trading ("HFT"). These operators make profits by keeping transaction costs to a minimum and concluding a very high volume of low-margin transactions, each executed within milliseconds. HFT is driven by algorithms and technical analysis. Since fundamental economic information is largely irrelevant, these transactions may be qualified as speculative in a Keynesian sense.⁴⁵ The FTT will increase transaction costs and possibly render this activity unprofitable.

20. The question therefore arises whether speculative trading is socially harmful. The discussion regarding the effectiveness of FTTs largely rests on the paradigm followed: financial economics based on the view that market prices (fully) incorporate fundamentals or a view more critical of market-efficiency.⁴⁶ A notable advocate of the first view is FRIEDMAN, who deemed speculation to be essentially stabilizing.⁴⁷ An often used argument is that speculation provides liquidity to financial markets, which is essential to their operation and price discovery.⁴⁸ FTT supporters, on the other hand, argue that the current level of market liquidity is excessive.⁴⁹ Furthermore, trading, based on expectation of market sentiment, leads to medium-term upward and downward trends, which are the result of aggregate short-term speculative transactions and pushes prices further away from their fundamental equilibria.⁵⁰ They lead to an increase in long-term volatility, thereby creating bubbles and, consequently, resulting in violent adjustments when prices have drifted too far from their equilibrium. These adjustments may in turn result in severe exogenous shocks in the real economy. Theoretical models and empirical studies have shown mixed results of FTT effect on short- and long-term volatility.⁵¹ It would seem that much of the disagreement can be retraced to the aforementioned competing paradigms, with respected economists on either side of the argument.

⁴⁵ Cf. D. SCHÄFER, "Financial Transaction Tax Contributes to More Sustainability in Financial Markets", *Intereconomics* 2012, 81 (hereafter: D. SCHÄFER, "Financial Transaction Tax").

⁴⁶ SCHULMEISTER identifies these underlying different views: S. SCHULMEISTER, "Boom-Bust Cycles and Trading Practices in Asset Markets, the Real Economy and the Effects of a Financial Transactions Tax", WIFO, 2010, 2 *et seq.*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1705628 (hereafter: S. SCHULMEISTER, "Boom-Bust Cycles").

⁴⁷ M. FRIEDMAN, "Essays in Positive Economics", Chicago, University of Chicago Press, 1953, 175.

⁴⁸ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 12.

⁴⁹ E.g.: S. SCHULMEISTER, "A General Financial Transactions Tax: Strong Pros, Weak Cons", *Intereconomics* 2012, 85 (hereafter: S. SCHULMEISTER, "Strong Pros, Weak Cons").

⁵⁰ S. SCHULMEISTER, "Boom-Bust Cycles", see *supra* note 46, 2-4.

⁵¹ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 20-22.

21. Higher transaction costs in general, however, are not as such effective in combating other possible causes of economic crises. The high amount of leverage (*i.e.* credit) in the financial system, for instance, is generally accepted to have greatly contributed to the recent crisis.⁵² The mere notion of financial transaction taxation does not imply a higher burden on substantially leveraged and risky instruments (e.g. credit default swaps) or on debt as a means of corporate financing. Such a distinctive treatment, however, may flow from certain design features (see e.g. no. 102). In this sense, FTTs certainly have an effect on risk and leverage, but this effect is more "coincidental" and other regulatory and tax measures may be better suited and more direct in attaining this goal.

2 FTTs as revenue-raising taxes

22. In the impact assessment accompanying the EU FTT Proposal, the revenue-estimate for the EU 27 (*i.e.* not yet including Croatia) of a FTT of 0,1% on securities and 0,01% on derivatives was between EUR 25 bn and 46 bn per annum.⁵³ The impact assessment with the EU 11 FTT Proposal estimates a revenue of EUR 31 bn per annum, a calculation based on the estimate in the first proposal. These estimates are more art than science and the Commission acknowledges that such calculations are always uncertain as they are necessarily based on a set of assumptions and proxies.⁵⁴ An important effect of FTTs is their impact on transaction volume (*i.e.* the tax base shrinks). Moreover, FTTs are often regarded as susceptible to avoidance, the extent of which will greatly influence final revenue collected. Swedish FTT, for instance, caused a sharp drop in trading volume and produced revenues which only amounted to about 3,33% of the estimates.⁵⁵ FTTs should not be discarded on this basis, however, as is shown by successful STTs. On the basis of figures of 2007 to 2009, seven countries collected a total of USD 22,66 bn in revenue with STTs, with high revenues for the UK (USD 5,86 bn) and South Korea (USD 6,08 bn).⁵⁶

23. The final welfare outcome depends on the use of the revenue collected. In the past, most supporters argued for the funding of development and charitable causes. Post-crises mentality induced a shift to revenue raising to cover the cost of the crisis. Under the EU 11 FTT, no agreement on this

⁵² E.g.: EC, "Impact Assessment EU FTT", see *supra* note 5, 10.

⁵³ EC, "Impact Assessment EU FTT", see *supra* note 5, 47.

⁵⁴ J. ENGLISH, J. VELLA and A. YEVGENYEVA, "The Financial Transaction Tax Proposal Under the Enhanced Cooperation Procedure: Legal and Practical Considerations", *British Tax Review* 2013, 230-231 (hereafter: J. ENGLISH *et al.*, "FTT Proposal Under the ECP").

⁵⁵ The revenue estimate was SEK 1500 mn per annum, the actual average revenue per annum around SEK 50 mn per annum: EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 8.

⁵⁶ Hong Kong (2009), India (2008), South Korea (2007), South Africa (2008), Switzerland (2007), Taiwan (2009) and UK (2008): S. GRIFFITH-JONES and A. PERSAUD, "Financial Transaction Tax", Paper prepared for the Committee on Economic and Monetary Affairs of the European Parliament, 6 February 2012, 15, www.stephanygi.net/papers/FTT.pdf (hereafter: S. GRIFFITH-JONES and A. PERSAUD, "Financial Transaction Tax").

issue exists yet. Without amendment of the Proposal, it is possible that revenue will flow into the general national treasury.

3 Possible adverse effects

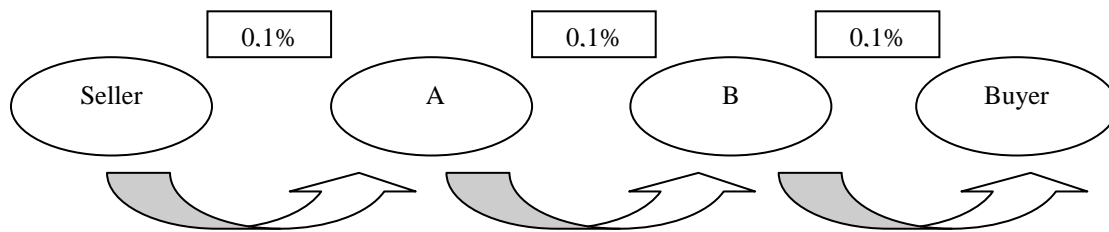
24. Raising transaction costs may also have some adverse effects. Debate exists on the intensity of these effects, which include lower market liquidity, reduction of asset value, more costly risk management because of the inclusion of hedging derivatives, adverse impact on repo transactions and securities lending, higher cost of capital, higher cost of sovereign debt and passing on of the tax burden to households.⁵⁷ The latter is quite obvious for FTTs that specifically target non-financial persons (e.g. Belgium), but might also be a problem for a financial sector FTT. Financial institutions may push down the tax burden to clients. All of these effects may hinder economic growth, reduce GDP or generate new factors of systemic risk.

25. Nevertheless, FTTs often find support in the argument that, given their low rate and broad base, potential distortions will be minimal. These adverse effects, however, may be exacerbated by cascading: a trait common to gross transaction taxes. Cascading occurs when one economic activity is conducted through a chain of separate operators. In a broad sense, cascading stretches out to effects on prices in a further stage of production from a tax imposed in an earlier stage. Specifically for financial markets, intermediaries very often interfere in the course of one economic transaction.⁵⁸ Take the example of a share transfer between two retail investors subject to a FTT of 0,1% on every leg of the transaction (*i.e.* every legal transaction). In a very straightforward scenario, two intermediaries (A and B) interfere and each leg of the transaction is at risk of being taxed, driving the final burden well above the standard tax rate (see **Figure I**). In reality, often a greater number of intermediaries interfere, together with central counterparties (see no. 72-79 and 111-115).

⁵⁷ See on these subjects: IMF, "Financial Sector Taxation", see *supra* note 2, 18; J. VELLA, C. FUEST and T. SCHMIDT-EISENLOHR, "The EU Commission's Proposal for a Financial Transaction Tax", *British Tax Review* 2011, 618; ICMA, "Collateral damage: the impact of the Financial Transaction Tax on the European repo market and its consequences for the financial markets and the real economy", 8 April 2013, 13, www.icmagroup.org/assets/documents/Regulatory/Repo/Collateral-damage---the-impact-of-the-FTT-on-the-European-repo-market-April-2013.pdf (hereafter: ICMA, "Collateral damage"); T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 37; EC, "Impact Assessment EU FTT", see *supra* note 5, 45-55.

⁵⁸ On the cascade effect see *inter alia*: IMF, "Financial Sector Taxation", see *supra* note 2, 19; T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 25 and 36; L. DE LA METTRIE, P. SONGNABA and D. MURRE, "The European Financial Transaction Tax: The New Reality", *Derivatives & Financial Instruments* 2013, 78.

Figure I - Cascade effect



Total tax burden = 0,3%⁵⁹

Depending on tax design, the occurrence of cascading may vary according to the legal qualification of the intermediary's actions. When differences exist, the impact of taxation could be different for various markets.⁶⁰

4 Are FTTs easily avoided?

26. All taxes can be avoided.⁶¹ This does not induce countries to abstain from taxation altogether. Financial transactions, however, have some specific features, which facilitate avoidance. Firstly, financial instruments are highly interchangeable. Parties may achieve a very similar or even equal economic result by substitution, *i.e.* taking recourse to a non-taxed instrument (see no. 38).⁶² Secondly, financial markets are globally interconnected and large financial institutions are active in several financial centres. Trading migration or relocation to non-taxing jurisdictions is a very real threat. Thirdly, FTTs may target certain entities (e.g. financial institutions) to safeguard others from the charge. Market players might try to transfer their trading activity to non-taxed entities (*cf.* shadow banking). Good tax design is paramount in curbing avoidance. In this the Swedish experience serves as a warning.⁶³

27. Tax avoidance (the non-prohibited use of a loophole) is to be distinguished from tax evasion, *i.e.* illegal conduct as a result of which no tax is paid (e.g. non- or misreporting). FTTs are liable to be evaded in certain circumstances, primarily when transactions are concluded outside the taxing jurisdiction.

⁵⁹ In this example, the tax base remains equal for each independent transaction.

⁶⁰ See no. 73-74.

⁶¹ S. GRIFFITH-JONES and A. PERSAUD, "Financial Transaction Tax", see *supra* note 56, 1.

⁶² Substitution possibilities are inherent to FTTs. Financial transactions can be structured in a myriad of ways, each with a different transactional intensity (*i.e.* amount of legal transactions): T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 29.

⁶³ D. SCHÄFER, "Financial Transaction Tax", see *supra* note 45, 82.

5 Conclusion: importance of balanced tax design in achieving the social optimum

28. The objectives mentioned above are to some extent incompatible. The reduction of harmful trading will lower revenue. Attempts to mitigate distortions might create leeway for avoidance. Furthermore, anti-avoidance measures widening tax scope might lead to legal issues. Policymakers will need to trade off objectives to come to a balanced tax design. It is for economists to assess whether the adoption of such a balanced FTT, socially optimal to having no FTT at all, is realistic.

III COMPARATIVE ANALYSIS OF TAX DESIGN

1 Methodology and rationale

29. The success of a tax depends on good tax design. Even though their aims are often very different, post-crisis FTTs could draw on the experiences of historical taxes. Several difficulties in tax design are neutral towards the goals pursued and techniques employed by traditional STTs are often educational. The following analysis has a second essential purpose. Several features in design have implications for and alter the assessment of a FTT's legality. This will form a recurring pattern in the second part of this thesis.

30. To attain a good balance of detail and comprehensiveness, the following method is used. A number of FTTs, which have been selected on the extent to which information is available and to which they each represent a certain distinct type, have been the primary focus of the comparative analysis. These are Belgian stock exchange tax, the EU 11 FTT Proposal, the recent French FTT, the recent Italian FTT and UK SDRT. UK stamp duty will only be dealt with when it is directly relevant to the operation of SDRT in practice. Limiting the research to these FTTs, however, would result in an incomplete view on the design options available. It would also neglect FTTs in some important financial centres such as Hong Kong, Taiwan and Singapore and historical FTTs, the results of which could prove useful in detecting weaknesses in FTT design (e.g. Sweden). Therefore, where useful, the analysis has expanded to other jurisdictions. As far as CTTs are concerned, Brazilian IOF and the symbolic Belgian CTT are included. Abolished FTTs are signalled with an asterisk (*).

2 Comparative analysis: overview of design options and selected issues

2.1 Taxable event

31. The taxable event is a specific occurrence defined by law that, in principle, automatically gives rise to tax liability. Certain requirements must be met for this occurrence to qualify as a taxable

event. These requirements may relate to the conduct that transpires (chargeable transaction), the nature of the persons involved (taxable person) and the location where it is taking place (territorial scope). It should be noted that these requirements only determine *whether* tax liability emerges and not who incurs liability or to what extent.

2.1.1 Chargeable transaction

2.1.1.1 *Object of the transaction: equity and debt securities, currencies and/or derivatives*

32. The central criterion is the object of the transaction, *i.e.* the substance that is being transacted between parties. FTTs may tax transactions in one or more of these instruments: (i) securities, including equity securities (e.g. shares) and debt securities (e.g. bonds), (ii) currency, and (iii) financial derivatives. See **Table II** for an overview of selected FTTs and references.

33. Equity instruments generally embody monetary and control rights and interests in a separate legal entity. Shares (or stocks) are the main form of equity securities. All of the existing FTTs tax transactions in shares, with the exception of pure CTTs. Debt instruments embody a legally enforceable claim for repayment of principal and usually payment of interest at a specific date or at specific dates. Examples are (government) bonds, medium term notes and money market instruments such as commercial paper. An important number of FTTs do not tax debt instruments or provide for an exemption. These include traditional stamp duties, but also the recent Italian and French FTT. Other FTTs, however, do tax (certain) debt instruments (e.g. Belgium), of which a number are now abolished. There is a noticeable tendency towards exemption or providing lower tax rates for fixed-income securities. EU 11 FTT taxes all securities, equity or debt. CTTs are directed at transactions in which two different currencies are exchanged for one another (spot transactions). CTTs may also be directed at FX derivatives (e.g. Belgian CTT).⁶⁴

34. The tax treatment of certain "equity-linked" debt securities poses some intricate issues. Examples are (reverse) convertible bonds or bonds of which interest calculation is somehow connected to the company's financial results. The former are debt instruments which, under certain conditions, may be "converted" into equity instruments (shares) by the bond holder (convertibles) or by the borrowing company (reverse convertibles). A first question is whether the transfer of hybrid debt securities should be taxed under equity-only FTTs. In a strict legal sense, convertible bonds are debt securities, but, in economic terms, they possess the upward potential (e.g. convertibles) or downward risk (e.g. reverse convertibles) of the underlying equity asset. Secondly, convertibles may also pose interpretative difficulties. UK stamp duty creates carve-outs in the exemption for debt for loan capital

⁶⁴ FX derivatives may be captured by the definition in Art. 4 *in fine* Law on foreign exchange taxation (BE).

giving rights to the acquisition of equity instruments or for which the interest is calculated on business results, thus treating it as chargeable equity.⁶⁵ In the absence of any specific provision, the legal structure of convertible instruments is essential. Convertible instruments are often qualified as incorporating an embedded derivative (e.g. a call option in case of convertible bonds). This implies that, in a system which taxes equity, debt and equity derivatives, four types of transactions could theoretically be chargeable: the conclusion of the embedded derivative agreement, the transfer of convertible bonds, the transfer of the embedded derivative and the conversion itself (the exercise of the option). The recent Italian FTT exempts *all* debt securities precisely to avoid any construction doubts in relation to convertibles.⁶⁶ Conversion as such, however, is only exempted if the shares are covered by the primary market exemption. In a similar vein, French FTT, which is already limited to French equity instruments, but would, in principle apply to convertible debt, specifically excludes the acquisition of bonds convertible into shares from its scope.⁶⁷ It is not entirely clear how convertible debt will be treated under the EU 11 FTT and no guidance is provided.⁶⁸

35. In addition to transactions in securities and currencies, FTTs may also tax derivatives. "Derivatives", for the purposes of this thesis, refers to derivatives contracts which exhibit features of three distinct categories: options, futures and forwards, and swaps. Some FTT legislation has a broader understanding of derivatives: e.g. also encompassing securities of which the value is linked to an underlying instrument (e.g. Italian FTT).⁶⁹ Structured products will usually already be implicitly included as equity or debt instruments, but could be the subject of an explicit provision (e.g. EU 11 FTT).⁷⁰

36. Some FTTs specifically target the conclusion, modification and/or transfer of derivative contracts. The first possibility is to tax (certain) derivatives when the underlying is a chargeable security (e.g. options on chargeable shares or equity swaps). Examples are the recent Italian FTT and Hungarian STT which has not yet entered into force.⁷¹ The question arises what the intensity of the

⁶⁵ Finance Act 1986 c.41 s.79 (5) and 79 (6) (UK) (hereafter: FA 1986). No stamp duty will be due, however, if the calculated interest and business results show an inverse relationship: Finance Act 2000 c.17 s.133 (UK) (hereafter: FA 2000).

⁶⁶ V. SALVADORI DI WIESENHOFF and R. EGORI, "2013 Italian Financial Transaction Tax", *Derivatives and Financial Instruments* 2013, 50 and 56 (hereafter: V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT").

⁶⁷ Art. 235 ter ZD (II) (9°) CGI (FR); Directorate General of Public Finances, "TCA - Taxe sur les transactions financières", 15 January 2014, <http://bofip.impots.gouv.fr/bofip/7570-PGP.html>.

⁶⁸ See M.J. PETERS, "*Capita Selecta* of the Financial Transaction Tax Proposed under Council Directive 2011/594" in O. MARRES and D. WEBER (eds.), *Taxing the Financial Sector: Financial Taxes, Bank Levies and More*, Amsterdam, IBFD, 2012, 31 (hereafter: M.J. PETERS, "*Capita Selecta* Financial Transaction Tax"), who notes that it is unclear whether both the embedded option and the bond should be subject to taxation or whether a "characteristic" transaction should be identified.

⁶⁹ E.g.: warrants and notes in securitization vehicles: V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 53.

⁷⁰ Art. 2 (3) EU 11 FTT Proposal.

⁷¹ Citibank, "Hungarian Financial Transaction Tax", 4 December 2013, 5, www.citibank.com/transactionservices/home/about_us/online_academy/docs/hungary_fin_update.pdf.

link to a chargeable security should be, e.g. in case of index or basket derivatives, which only partly relate to chargeable securities. Italian requires the underlying value or the derivative's value to depend for more than 50% on the value of chargeable securities.⁷² Surprisingly, CDSs are excluded since their value is not considered to be related to the value of the underlying equity (*i.e.* their market price).⁷³ This approach clearly leaves some avoidance opportunities. A second option is to impose the tax on other financial derivatives, which do not necessarily bear a direct link to chargeable securities, but to currencies, commodities, interest rates, indexes (irrespective of whether they contain chargeable securities), non-chargeable securities, etc. Examples are French FTT which charges "unhedged" credit default swaps on sovereign debt, the proposed Indian commodity transaction tax and Taiwanese futures transaction tax.⁷⁴ South Korea is planning to adopt a tax on index futures and options, effective as from 2016.⁷⁵ EU 11 FTT is unique in its attempt to tax *all* financial derivatives and thereby eliminate avoidance opportunities. Nevertheless, some limitation will necessarily result from the boundaries of the definition given to derivatives. EU 11 FTT refers to points (4) to (10) Section C Annex I of MiFID.⁷⁶ EU 11 FTT accordingly sets out to tax *inter alia* all types of derivatives relating to securities, currencies, other derivatives or financial indices and measurements, both when they are physically or cash settled, off-exchange cash-settled commodity derivatives, on-exchange commodity derivatives, credit derivatives, and CFDs.

37. This section is concerned with FTTs specifically undertaking to charge derivatives. Taxation of derivatives under other, more traditional, FTTs is possible, but more "incidental" (see no.58).

38. A number of factors are relevant in determining the appropriate scope in light of the aforementioned objectives. Including a wide range of instruments clearly has some advantages. Firstly, a broader scope with regard to instrument type will, in principle, generate a higher revenue. Secondly, a narrow scope may offer considerable leeway for tax avoidance through substitution.⁷⁷ The pivotal issue here is to what extent financial instruments are interchangeable. Derivatives are the instruments *par excellence* in reflecting the value of the underlying instrument, without actually owning it. Market participants, for example, have very early on used contracts for difference ("CFDs")

⁷² V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 53.

⁷³ Italian Ministry of Economics and Finance, "Financial Transaction Tax (Derivative Instruments and Other Securities)", www.finanze.gov.it/export/download/novita2013/FAQ_FTT_Derivati_23_8_2013_clean_ENG_sent.pdf, 1.

⁷⁴ See note 80.

⁷⁵ W. HAN and H. OH, "Introduction of derivatives transaction tax", *Lexology*, 21 August 2012, www.lexology.com/library/detail.aspx?g=36059fe6-32c2-4975-a5ea-df9808f12fd6.

⁷⁶ Art. 2 (1) (4) EU 11 FTT Proposal; Section C Annex I Directive Parliament No. 2004/39/EC, 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, *OJ. L.* 30 April 2004, 145, 1. (hereafter: MiFID).

⁷⁷ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 27.

to avoid UK SDRT.⁷⁸ This method will only be available, however, when ownership of the underlying security is not necessary (e.g. to exercise voting or control rights). Such substitution to non-taxed instruments would lead to lower revenue. Moreover, the FTT would overshoot its objectives and could possibly even generate additional risk due to an excessive use of substitutes. Not including debt securities, for instance, exacerbates the existing bias most national income tax systems have in favour of debt financing, which is undesirable in the light of the recent crisis.⁷⁹ Clearly, the same logic is applicable to derivatives, in particular risky over-the-counter ("OTC") derivatives. However, broad based FTTs also have disadvantages. Tax collection may be more problematic and costly for some types of instruments (e.g. OTC derivatives not centrally settled). Furthermore, additional distortions (e.g. higher cost of capital) arise and there is a higher chance that certain transactions, efficient from a total welfare point of view, are affected. This last issue will be further examined below (exemptions).

Table II - Taxable object: selected FTTs (excluding CTTs)

	Transfer of equity instruments	Transfer of debt instruments	Conclusion of derivatives linked to chargeable securities	Conclusion of other financial derivatives
Belgium	X	X	-	-
EU 11	X	X	X	X
Finland	X	-	-	-
France	X	-	-	X ("naked" credit default swaps on sovereign debt)
Germany*	X	X	-	-
Greece (for shares acquired prior to 1 January 2013)	X	-	X (if on-exchange and under strict circumstances for OTC transactions)	-
Cyprus	X	-		
Hong Kong	X	-	-	-

⁷⁸ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 28. A CFD entitles the "buyer" to the profits, while bearing the risk of losses, on the underlying instrument. CFDs often incorporate a leverage factor and require margins to be posted.

⁷⁹ Interest payments on debt are very often tax deductible, whereas distributions to equity holders are not. J. ANTHONY, M. BIJLSMA, A. ELBOURNE, M. LEVER and G. ZWART, "Financial transaction tax: review and assessment", CPB Discussion Paper, 16 January 2012, 19, www.cpb.nl/publicatie/financi%C3%ABle-transactiebelasting-bespreking-en-beoordeling (hereafter: J. *et al.*, "FTT: review and assessment").

India	X	-	X	X (proposed tax on commodity futures)
Ireland	X	-	-	-
Italy	X	-	X	-
Japan*	X	X	N/A	-
Malta	X	X	-	-
Netherlands*	X	X	-	-
Poland	X	X	-	-
Singapore	X	X ("funded debt" as defined in case law)	-	-
South Africa	X	-	-	-
Sweden*	X	X (from 1989 onwards)	X (share options)	-
Switzerland	X	X	-	-
Taiwan	X	X (temporarily exempted until 31 December 2016)	-	X (on-exchange futures and options on indexes, interest rates and gold)
UK	X	- (exception: equity-linked debt under certain conditions)	-	-
USA stamp duty*	X	X	N/A ("rights to acquire chargeable interests" are included, <i>i.e.</i> options?)	-

*: abolished

N/A: not available, *i.e.* no definite answer. Remarks between brackets.

Sources⁸⁰

⁸⁰ **General:** EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 492 *et seq.* and Annex 8, 2-11; B. CORTEZ and T. VOGEL, "Financial Transaction Tax", see *supra* note 43, 23-25; B. LARKING, "Existing National

2.1.1.2 On- and/or off-exchange traded instruments

39. With regard to securities, several FTTs distinguish between on- and off-exchange traded instruments. FTTs may exclude or exempt listed securities. Cyprus, for instance, abolished its STT on transactions on the Cyprus stock exchange and now only taxes off-exchange sales of shares. Other examples are Finland, Malta and Poland.⁸¹ Certain stamp duties may also *de facto* exclude on-exchange transactions when they do not cater for electronic transactions as the UK and Ireland do. Accordingly, Singaporean stamp duty is not levied on transactions on the Singapore stock exchange settled through the scrip-less system.⁸² Some FTTs are directed solely at listed securities. French FTT is the most important example and is only applicable to shares listed on a French or foreign regulated market or recognised foreign market.⁸³ The Greek STT also solely applied to listed shares.⁸⁴

40. FTTs that do not distinguish between instruments traded on or off exchange usually add a condition to their definitions of chargeable securities, *viz.* securities should be "marketable" (e.g. Ireland), "public" (e.g. Belgium) or "transferable" (EU 11 FTT).⁸⁵ In general, these conditions imply that the nature of the securities should not stand in the way of being traded on the capital markets, although differences may exist. "Transferable" for the purposes of EU 11 FTT means that securities

Taxation", see *supra* note 43, 40; KPMG, "Overview of taxes on financial transactions within the EU", www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/financial-transaction-tax-survey/Pages/default.aspx. **BE:** Art. 120 *Wetboek diverse rechten en taksen* (BE) (hereafter: WDRT). **EU 11:** Art. 2 (1.) (3) EU 11 FTT Proposal *juncto* (1) Section C Annex I MiFID: transferable securities, money market instruments, units in collective investment undertakings and various derivatives are included. **FR:** Art. 235 ter ZD (I) CGI *juncto* Art. L. 212-1 A *Code monétaire et financier* (instruments that confer voting rights or access to company capital); Art. 235 ter ZD ter CGI. **IE:** Stamp Duties Consolidation Act 1999 (SDCA 1999) s.85 (2) (b). **IN:** P. CHIDAMBARAM, "Budget 2013-2014: Speech of P. Chidambaram, Minister of Finance", 28 February 2013, 25, <http://indiabudget.nic.in/ub2013-14/bs/bs.pdf>. **IT:** V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 50. **NL:** Dutch House of Representatives, "Voorstel van wet van het lid De Grave tot wijziging van de Wet op belastingen van rechtsverkeer (afschaffing beursbelasting)", 2, http://ressourcessgd.kb.nl/SGD/19891990/PDF/SGD_19891990_0005221.pdf. **ZA:** SARS, "Securities Transfer Tax", www.sars.gov.za/TaxTypes/STT/Pages/default.aspx. **CH:** Art. 1 (b) (1) Bundesgesetz vom 27. Juni 1973 über die Stempelabgaben, AS 1974, 11 ff (hereafter: StG). **TW:** KPMG, "Taiwan Tax Profile", 2013, 11, www.kpmg.com/Global/en/services/Tax/regional-tax-centers/asia-pacific-tax-centre/Documents/CountryProfiles/Taiwan.pdf. **UK:** FA 1986 c.41 s.99 (5) *juncto* s.79 (4). **US:** L.H. SUMMERS and V.P. SUMMERS, "When Financial Markets Work Too Well: A Cautious Case For a Securities Transactions Tax", *Journal of Financial Services Research* 1989, 277-279.

⁸¹ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 476, 477 and 520; KPMG, "Overview of taxes on financial transactions within the EU - Malta", www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/financial-transaction-tax-survey/Pages/Malta.aspx.

⁸² EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 722.

⁸³ Art. 235 ter ZD (I) CGI (FR).

⁸⁴ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 476, 477 and 585. This does not mean, however, that OTC transfers in listed instruments are not chargeable.

⁸⁵ SDCA 1999 s.69 (1) *juncto* 68 (1) (IE); Art. 120 WDRT (BE); Art. 2 (1) (3) EU 11 FTT Proposal *juncto* Paragraph (1) Section C Annex I MiFID.

should be "*negotiable on the capital market*".⁸⁶ This condition is quite inclusive and only in limited circumstances will securities not be transferable.⁸⁷

41. With regard to derivatives, the question is whether taxation of OTC contracts is administratively feasible (see no. 118). EU 11 FTT does not distinguish between exchange-traded and OTC instruments.

2.1.1.3 High-frequency trading

42. The Italian and French FTTs institute regimes to dissuade high-frequency trading. The definition of HFT could be based on the very short time interval in between trades and the algorithmic driven nature of HFT.⁸⁸ Under Italian FTT, the notion of chargeable instruments is broader for HFT. The French and Italian taxes on HFT are separate charges on the value of HFT transactions which are amended or cancelled exceeding a certain threshold percentage of total daily trading volume.

2.1.1.4 Primary market operations and restructuring

43. Primary market transactions relate to the original issuance of securities⁸⁹, *i.e.*, in a strict sense, the creation of a claim embodied in the security against capital contributions (equity) or some form of credit (debt). In a broader sense, issuance stretches out to the first transfer or even subsequent transactions usually necessary to transfer the security to the end investor. Secondary market transactions, in contrast, encompass all further transactions between investors relating to these securities. Primary market transactions may be exempted to safeguard the capital-raising ability of businesses and governments.⁹⁰ Outside the EU, some STTs tax issuance (e.g. Switzerland on equity issuance).⁹¹ Within the EU, the Capital Duty Directive ("CDD") puts extensive restrictions on the taxation of the raising of capital.⁹² The extent of these restrictions is discussed further below. Most European FTTs now exclude or exempt primary market transactions (e.g. Belgium, France, Italy,

⁸⁶ Art. 4 (18) MiFID.

⁸⁷ P. SCHAMMO, *EU Prospectus Law. New Perspectives on Regulatory Competition in Securities Markets*, Cambridge, Cambridge University Press, 2011, 82.

⁸⁸ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 59-60; Art. 235 ter ZD bis CGI (FR).

⁸⁹ The dichotomy primary vs. secondary market transactions cannot be applied to derivatives.

⁹⁰ Recital 8 EU 11 FTT Proposal.

⁹¹ Art. 1 (1) (a) StG (CH): *Emissionsabgabe*.

⁹² Directive Council No. 2008/7/EC, 12 February 2008 concerning indirect taxes on the raising of capital, *OJ. L.* 21 February 2008, 46, 11 (hereafter: Capital Duty Directive or CDD).

UK).⁹³ The EU 11 FTT, contrary to the first Proposal, cannot amend the CDD and exempts all primary market transactions.⁹⁴

44. As noted above, a broad definition of primary market transactions encompasses transactions necessary to transfer the securities to end investors. Issuers are usually assisted by financial institutions (e.g. investment banks) through the initial public offering of securities. In some instances, these transactions are potentially liable to FTT: e.g. in case of underwriting, in which the institution purchases securities as a principal and sells them on the investors, or even when the institution is acting as agent (e.g. EU 11 FTT, see no. 73). Contrary to the first Proposal, EU 11 FTT explicitly exempts all underwriting activity and subsequent transactions to allocate financial instruments in the framework of their issue.⁹⁵ Other countries explicitly providing for an exemption are France and the UK.⁹⁶ It is possible that other FTTs are interpreted to also exempt these transactions, especially those in EU Member States subject to the CDD.

45. Issuance is often accompanied by several complementing operations conducted by the assisting financial institution. Examples are operations aimed at increasing trading liquidity and those aimed at stabilizing the price of the issued securities. In the EU, these may be legitimate as accepted market practices. Italian and French FTT exempt liquidity operations qualifying as accepted market practices under certain conditions.⁹⁷

46. Multiple transactions part of company restructuring operations could attract FTT. Examples are company takeovers by means of share acquisition, legal mergers and demergers when shares are transferred, contributions in kind of company shares, etc. An exemption for these transactions is tenable on account of FTT objectives. Company restructurings are closely connected to the real economy, direct investment and economic growth. These operations are deemed to be closely related to the freedom of capital movements.⁹⁸ In the field of indirect taxation, the CDD provides that Member States may not subject certain restructuring operations of capital companies to indirect taxation.⁹⁹ EU

⁹³ For Belgium and UK see no. 194; Art. 235 ter ZD (II) (1) CGI (FR); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 56.

⁹⁴ Art. 3 (4) (a) EU 11 FTT Proposal. Under the previous Proposal, issuance of units in collective investment funds (namely UCITS and AIF) were subject to taxation: Art. 1 (4) (a) EU FTT Proposal.

⁹⁵ Art. 3 (4) (a) EU 11 FTT Proposal.

⁹⁶ Art. 235 ter ZD (II) (1) CGI (FR); FA 1986 c.41 s.98 (A) (1) and (2) (UK). UK SDRT, however, does not exempt purchases done by the institution of securities which were not allotted to end investors: HMRC, "Stamp Taxes Manual", see *supra* note 17, 266.

⁹⁷ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 58; Art. 235 ter ZD (II) (4^o) CGI (FR). Italian FTT: only for the person having concluded a liquidity contract (not the counterparty). French FTT: exempted when the purchases are made *for the account of the issuer* (not when acting as principal).

⁹⁸ E.g.: CJEU C-372/10, *Pak-Holdco sp. Z o.o. v. Director of the Tax Chamber in Poznan*, not yet published, para 29; Recital (2) and (3) CDD.

⁹⁹ Art. 5 (1) (e) CDD. For the definition of restructuring operations see Art. 4 of the CDD.

11 FTT exempts these operations.¹⁰⁰ Other European FTTs provide for some kind of relief in case of corporate restructurings (e.g. France, Italy and UK).¹⁰¹ In Singapore, share acquisitions are temporarily exempted under certain conditions in the framework of its "M&A Scheme".¹⁰²

2.1.1.5 Exemptions for certain instruments

47. Instruments are often exempted to limit certain distortions. When debt is subject to FTT, instruments issued by sovereign debt agencies may be exempted. Belgian stock exchange tax exempts certain sovereign debt instruments generally held by institutional investors.¹⁰³ Other examples of FTTs exempting (certain) government debt are Polish CLAT and the former US stamp duty.¹⁰⁴ EU 11 FTT does not exempt government debt. Some argue that this will drive up sovereign financing costs. Swedish FTT did not exempt government bonds, which led to a large decrease in trading volume.¹⁰⁵

48. A second type of transactions which are often deemed useful and therefore exempted are repurchase agreements ("repos") and securities lending operations.¹⁰⁶ Repos are essentially collateralized short-term (often overnight) cash-lending¹⁰⁷ operations structured as two consecutive and mirrored transactions. The lender acquires securities, usually (sovereign) bonds, from the borrower for a specified amount which will generally be lower than their market value (*i.e.* the "haircut"). At the end of the lending period, the borrower repurchases the securities from the lender for a price incorporating the principal (the original purchase price) and interest. The lender is protected against the borrower defaulting by its property interest in the collateral. In practice, repo transactions may be more complex.¹⁰⁸ Securities lending is largely similar, but is directed at the borrowing of securities instead of cash. Conversely to repos, the borrower acquires securities (usually equity) from the lender and provides cash or other securities in return as collateral. The lender is entitled to a fee, which he may deduct from the cash collateral held. Several jurisdictions provide for exemptions under

¹⁰⁰ Art. 3 (4) (a) EU 11 FTT Proposal.

¹⁰¹ Art. 235 ter ZD (II) (5) CGI (FR); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 56; FA 1986 c.41 s.75, 76 and 77 (UK).

¹⁰² Section 15A Stamp Duties Act (Chapter 312) (2006 revised edition) (SG).

¹⁰³ *Viz.* linear bonds and treasury certificates: see Art. 126/1 (6) WDRT.

¹⁰⁴ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 8, 4; L.H. SUMMERS and V.P. SUMMERS, "When Financial Markets Work Too Well: A Cautious Case For a Securities Transactions Tax", *Journal of Financial Services Research* 1989, 277.

¹⁰⁵ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 17.

¹⁰⁶ For an explanation see: ICMA, "Frequently Asked Questions on Repo", 35 p., www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/frequently-asked-questions-on-repo.

¹⁰⁷ A "special", however, is a repo which is directed at the lending of securities.

¹⁰⁸ In reality, third parties (tri-party agents) may intervene in the conclusion and administration of the repo, additional collateral is extended before the end of the contract, etc.

certain conditions to safeguard these markets (e.g. France, Hong Kong, Ireland, Italy, UK).¹⁰⁹ EU 11 FTT explicitly subjects repurchase agreements and securities lending to the charge, but qualifies repos as one single transaction as opposed to the first Proposal (both purchase and repurchase were chargeable).¹¹⁰ Repos and securities lending with securities as collateral may even bear a higher burden, since collateral management during the life of the contract might also be liable to FTT.¹¹¹ Furthermore, FTTs might employ an at arm's length standard (e.g. EU 11 FTT), which implies that for repos the tax charge will be calculated on market value and not on the principal amount.¹¹² For more information on these transactions see no. 169 and 176-177.

49. Units or shares in collective investment funds are a third type of instrument for which special regimes or exemptions exist. When transactions within the fund itself are subject to FTT (see no. 69), an additional charge may put a disproportionate burden on collective investment. Policy makers may wish to prevent this by granting an exemption. Accordingly, UK SDRT exempts transfers of units in collective investment schemes. Belgian stock exchange tax exempts transfers of units in private and institutional collective investment funds, but not in those open to the public.¹¹³ Moreover, redemptions of units by the fund may be subject to a specific tax regime. Examples are Belgium (separate charge on "accumulating shares"¹¹⁴ in SICAVs) and the UK ("Schedule 19" SDRT to be paid by the fund's manager), the latter of which is now abolished.¹¹⁵ Sometimes both transfers and redemptions are exempted from any charge (e.g. Italy, Malta and UK).¹¹⁶ EU 11 FTT is imposed on both the transfer and redemption of units in collective investment undertakings (both UCITS and AIF), but not on their issuance, as opposed to the first Proposal.¹¹⁷

¹⁰⁹ Art. 235 ter ZD (II) (6) CGI (FR); Inland Revenue Department Hong Kong, "Relief for Stock Borrowing and Lending Transactions", 2011, 35 p., www.ird.gov.hk/eng/pdf/e_soipn02.pdf; SDCA 1999 s.73 (IE); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 56: in addition, buy/sell-backs and transfers of ownership in the framework of collateral arrangements in general are excluded; FA 1986 c.41 s.98AA (UK).

¹¹⁰ Art. 2 (1) (2) (e) and 2 (2) EU 11 FTT Proposal.

¹¹¹ EC, "How the FTT works in specific cases and other questions and answers", 36, http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/ftt_examples.pdf (hereafter: EC, "Specific Cases").

¹¹² This does not apply for securities lending, since cash collateral is higher than the market value of the securities. ICMA, "Collateral damage", see *supra* note 57, 13.

¹¹³ Art. 126/1 (3) and (10) WDRT (BE).

¹¹⁴ "Accumulating shares" are those which do not lead to regular distributions of profit in the form of dividends and for which the accumulated profit is incorporated in the redemption price.

¹¹⁵ Art. 120 (3) WDRT (BE); HMRC, "Abolition of stamp duty reserve tax applied to collective investment schemes", www.gov.uk/government/uploads/system/uploads/attachment_data/file/264469/17_Abolition_of_Stamp_Duty_Reserve_Tax_applied_to_collective_investment_schemes.pdf.

¹¹⁶ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 59; KPMG, "Overview of taxes on financial transactions within the EU - Malta", www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/financial-transaction-tax-survey/Pages/Malta.aspx.

¹¹⁷ Explanatory Memorandum EU 11 FTT, see *supra* note 42, 8.

50. Securities issued by smaller companies could be exempted to limit the increase in capital cost for SMEs. Accordingly, Italian FTT excludes listed shares with a limited market capitalization, *i.e.* less than EUR 500 mn in November of the previous year.¹¹⁸ French FTT only applicable to shares with a market capitalization exceeding EUR 1 bn in December of the previous year.¹¹⁹ The UK government is planning to exempt shares listed on certain "growth markets".¹²⁰

51. Several other types of transactions may be exempted for various economic or other reasons. Examples are securities acquired within the framework of an employee remuneration program (e.g. France and UK)¹²¹ and money market paper (e.g. Switzerland)¹²².

2.1.1.6 Exemptions for certain transactions

52. In a similar vein, FTTs may also exempt certain types of transactions, regardless of the instrument involved. Transactions part of state policy or in the framework of emergency situations may, for instance, be exempted. The best example are transactions with central banks (e.g. EU 11 and Italy).¹²³ Other examples include transactions with EU and international institutions and emergency vehicles such as the EFSF and the ESM.¹²⁴ Instead of exempting debt agencies and similar entities as such (see no. 68), countries may exempt the whole of the transaction when such an agency is a party (e.g. Belgium).¹²⁵

53. An often heard criticism of derivatives taxation is that hedging transactions will equally bear the tax burden, next to purely speculative transactions, thus making risk management more expensive. SCHULMEISTER refutes this argument.¹²⁶ In his opinion, FTT schemes could set up classification mechanisms, allowing for the identification of hedging transactions to be exempted. This might indeed be possible for pure hedging by non-financial firms. It would be more difficult to grant an exemption, however, when derivatives have both a speculative and a hedging component. Furthermore, jurisdictions would have to decide whether counter positions taken by financial firms to "hedge" pre-existing speculative positions would qualify. Nevertheless, FTTs rarely provide for an exemption due to the avoidance risk and enforcement costs this entails. In an effort to limit effects on hedging, the proposed Indian commodity derivatives tax does exempt certain underlying agricultural

¹¹⁸ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 49.

¹¹⁹ Art. 235 ter ZD CGI (I) (FR).

¹²⁰ HMRC, "Abolition of stamp duty and stamp duty reserve tax: securities admitted to trading on recognised growth markets", 17 March 2012, 6 p., www.hmrc.gov.uk/so/abolition-stamp-duty-and-sd-reserve-tax.pdf.

¹²¹ Art. 235 ter ZD CGI II (7) and (8) (FR); FA 2000 c.17 Schedule 8 para 116A (UK).

¹²² EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 730.

¹²³ Art. 4 (c) EU 11 FTT Proposal; Art. 16 (1) (a) L. 24 December 2012, n. 228 (IT).

¹²⁴ Art. 4 (d)-(f) EU 11 FTT Proposal; Art. 16 (1) (a) L. 24 December 2012, n. 228 (IT).

¹²⁵ Art. 126/1 (5°) WDRT (BE).

¹²⁶ S. SCHULMEISTER, "Strong Pros, Weak Cons", see *supra* note 49, 89.

commodities.¹²⁷ Such an exemption is easier to administer, but provides no safeguard against speculative activity shifting towards exempted commodities.

2.1.1.7 "Transactions": moment of chargeability

54. It is constitutive for tax liability that a transaction takes place (transaction tax) or is evidenced or referenced in a document or equivalent instrument (traditional stamp duties).

55. FTTs could charge the conclusion of agreements for the sale and purchase of securities (or currencies) and sometimes, more generally, agreements pursuant to which ownership is transferred (e.g. Belgium, Greece* and UK).¹²⁸ French FTT charges the *acquisition* of chargeable securities *insofar* as this leads to a transfer of ownership. Italian FTT is applicable to the transfer of ownership of chargeable securities as such. The way in which "transfer of ownership" of securities held in investment accounts is defined implies that settlement is a requirement for chargeability.¹²⁹ If, in turn, settlement is understood as actual physical delivery, this could imply that only net positions are subject to FTT. For the purposes of French FTT, for instance, transfer of ownership is deemed to occur upon entry into the purchaser's investment account. Only net buying positions will be settled and, consequently, entered into this account.¹³⁰ The above does not imply that FTTs which apply to the transfer of securities or currencies could not opt to use clearing and settlement (or e.g. the execution of a document in case of stamp duties) as an additional requirement for chargeability. In this case, payment made by setting off claims for delivery against reverse claims of the counterparty also gives rise to a taxable event, thus allowing for the taxation of the gross amount (e.g. Belgian CTT).¹³¹ Lawmakers should be mindful of national law and concepts when defining the moment of chargeability.

56. Financial transactions, as defined by EU 11 FTT, encompass *inter alia* the purchase and sale of financial instruments before netting or settlement.¹³² This terminology should not be interpreted from a national viewpoint, but has an autonomous meaning. As stated in the explanatory

¹²⁷ P. CHIDAMBARAM, "Budget 2013-2014: Speech of P. Chidambaram, Minister of Finance", 28 February 2013, 25, <http://indiabudget.nic.in/ub2013-14/bs/bs.pdf>.

¹²⁸ Art. 120 WDRT (BE); EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 585; HMRC, "Stamp Taxes Manual", see *supra* note 17, 250.

¹²⁹ Art. 235 ter ZD (I) CGI (FR), referring to Art. L 211-17 *Code monétaire et financier* which explicitly provides that ownership over instruments within CSDs is transferred upon entry in the purchaser's investment account; V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 50: for securities held by CSDs, transfer of ownership coincides with the settlement date. The settlement date is "*the date of registration of the transfers, following the settlement of the relevant transaction*".

¹³⁰ PwC, "French Financial Transaction Tax on Equity Securities: Latest developments and practical implications for the market", 14 August 2012, 4-5, www.pwc.com/gx/en/financial-services/financial-transaction-taxes-timeline/assets/french-aug1.pdf (hereafter: PwC, "French FTT").

¹³¹ Art. 6 (§2) and 7 Law on foreign exchange taxation.

¹³² Art. 2 (2) (a) EU 11 FTT Proposal.

memorandum, it is not limited to agreements leading to the transfer of legal title, but also includes transactions where a party, as a result of the transaction, assumes the risk implied by a given financial instrument.¹³³ An example is the sale of beneficial interest in nominee-registered securities, which is possible in some jurisdictions.

57. It may furthermore be required that this transfer of ownership is conducted against consideration (e.g. Belgium, France and UK).¹³⁴ As a consequence, transfers resulting from, for example, (formal) gifts or inheritances are not chargeable. FTTs which do not prescribe consideration as a constitutive element of tax liability, can achieve the same result, e.g. by explicitly exempting such transactions (e.g. Italy).¹³⁵ Issues may also arise when consideration exists of other chargeable instruments, *i.e.* an exchange of securities. EU 11 FTT explicitly provides that such agreements should be regarded as giving rise to two separate taxable transactions.¹³⁶

58. As noted above, the conclusion of a derivatives contract may constitute a taxable event. Furthermore, STTs could become due on derivatives relating to chargeable securities as a result of the definition given to securities transactions as such. This is often the case when chargeable securities are transferred as a result of physically delivered futures/forwards and exercised options (e.g. EU 11, Finland, France, Italy, Sweden* and UK).¹³⁷ It is also conceivable that STTs, when the definition of securities transactions is interpreted very broadly, extend to the actual conclusion of futures/forwards and options, even though they do not, in principle, aim to tax the conclusion of derivatives. Much depends on the legal structure of these contracts in the respective jurisdictions and the extent to which legislators and tax authorities are willing to disregard contract law when applying tax rules. For example, the conclusion of futures may attract Polish CLAT, which is not devised in terms of a chargeable object, but generally applicable to any contract which leads to the transfer of property and on which VAT is not levied.¹³⁸ The same could be true for other, more genuine, STTs. The resources consulted for this thesis, however, did not provide a conclusive answer.

¹³³ Explanatory Memorandum EU 11 FTT, see *supra* note 42, 8; O. HENKOW, "The FTT Proposal - An Overview of Legal Issues Arising" in O. MARRES and D. WEBER (eds.), *Taxing the Financial Sector: Financial Taxes, Bank Levies and More*, Amsterdam, IBFD, 2012, 10 (hereafter: O. HENKOW, "FTT Proposal").

¹³⁴ Art. 120 (1) WDRT (BE); Art. 235 ter ZD (I) CGI (FR); HMRC, "Stamp Taxes Manual", see *supra* note 17, 250.

¹³⁵ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 56.

¹³⁶ Art. 2 (2) EU 11 FTT Proposal.

¹³⁷ Explanatory Memorandum EU 11 FTT, see *supra* note 42, 8; M.J. PETERS, "Capita Selecta Financial Transaction Tax", see *supra* note 68, 29; EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 558 and 707; Art. 235 ter ZD (i) (par 2) CGI (FR); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 55; B. CORTEZ and T. VOGEL, "Financial Transaction Tax", see *supra* note 43, 25.

¹³⁸ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 657.

59. In order to prevent avoidance, modifications of existing chargeable agreements could also be subject to taxation. EU 11 FTT applies to "material modifications".¹³⁹ Accordingly, rollovers of derivatives, novation and the supply of additional collateral may attract FTT.¹⁴⁰ Italian FTT is imposed on modifications of derivatives, defined as a variation of notional value, parties or maturity.¹⁴¹

2.1.1.8 Conclusion

60. One would expect steering FTTs to have a broad objective scope, incorporating all transactions which are functionally alike. Any other approach could fuel a shift towards non-taxed products, sometimes even riskier than the behaviour originally targeted. Traditional STTs are not concerned with this. The number of persons not trying to avoid the tax, often retail investors, still provide for sufficient revenue. But post-crisis FTTs do not always follow this approach either. The general equity-only French FTT is a good example and is clearly more in line with traditional stock exchange taxes, notwithstanding the separate charge on HFT and CDSs. Italian FTT goes further and targets equity-linked derivatives. Few FTTs, however, tax debt securities and none tax financial derivatives in general, EU 11 FTT being the notorious exception. In this respect, EU 11 FTT would truly be the world's first "universal" FTT on all transactions contained in the FTT definition of this thesis, with the exception of spot currency transactions. Recent political developments, however, have made it likely that EU 11 FTT will (initially) only be imposed on equity and its derivatives.¹⁴² This would be a tax similar to Italian FTT and therefore much closer to traditional STTs. It remains to be seen whether any new proposal would still sufficiently translate the objective of adopting a stabilizing tax on the financial sector into practice. Given the exclusion of debt, this is now much more uncertain. Exemptions usually serve to mitigate distortions. Furthermore, some transactions should be free from suspicion as to their non-speculative nature (e.g. share purchases in workers' participation schemes). EU 11 FTT is much less liberal than traditional STTs and French and Italian FTT. The underlying idea is probably that exemptions create avoidance opportunities and inequalities. While this is certainly true in many instances, it is arguably not for repo and securities lending taxation. In the author's view, the current tax treatment, *i.e.* an ad valorem tax on the market value of the collateral, is highly disproportionate as to the value of the transaction, creates inequalities between short-term lending operations and it is not sufficiently explained why these operations should be disincentivized (see no. 176-177).

¹³⁹ Art. 2 (2) EU 11 FTT. An example is a modification which would have led to a higher tax amount had the transaction been concluded as modified.

¹⁴⁰ Cf. M.J. PETERS, "Capita Selecta Financial Transaction Tax", see *supra* note 68, 29.

¹⁴¹ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 54.

¹⁴² A. BARKER, "Eurozone divided over financial transaction tax deal", *FT*, 6 May 2014, <http://www.ft.com/intl/cms/s/0/d8a5d630-d529-11e3-9187-00144feabdc0.html#axzz30xBE1uC9>.

2.1.2 Taxable Person

2.1.2.1 General FTT or aimed at financial institutions

61. Most FTTs are applicable to one or both parties to a chargeable transaction as a starting point. Subsequently, specific exemptions are introduced. Some FTTs, do require that at least one financial intermediary is involved in the transaction, *i.e.* as an agent or principal (e.g. Belgium, Sweden* and Switzerland).¹⁴³ This requirement aligns the conditions for tax liability with tax collection, *i.e.* the intermediary will act as a collecting agent (see no. 116).

62. EU 11 FTT, as a "bank tax", applies solely to financial institutions. This implies that tax liability will only arise when at least one party to a chargeable transaction is a financial institution, acting for its own account or for the account of another.¹⁴⁴ This, however, does not mean that financial institutions could not economically recoup the tax burden from clients (e.g. through higher fees).

63. EU 11 FTT takes two approaches in defining financial institutions. Firstly, financial institutions are the entities regulated by other EU legislation and listed in Article 2 (8) (a) to (i).¹⁴⁵ Accordingly, a broad range of financial firms and entities qualify: e.g. banks, insurance firms, collective investment funds, pension funds, securization vehicles, etc. Secondly, any legal or natural person may qualify as financial institution when its average annual value of financial transactions in the sense of EU 11 FTT surpasses 50% of average net annual turnover¹⁴⁶ and it carries out one of the activities listed in Article 2 (8) (j) (i) to (v).¹⁴⁷ This provision is quite inclusive and probably aimed at preventing transfers of trading activity to non-financial institutions. It might, however, lead to unexpected results extending FTT beyond the financial sector: e.g. holding companies and corporate treasury centres qualifying as financial institutions.¹⁴⁸

¹⁴³ Art. 126/1 (1) WDRT (BE); EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 8, 8-9.

¹⁴⁴ Art. 3 (1) EU 11 FTT Proposal.

¹⁴⁵ E.g.: credit institutions, investment firms, insurance and reinsurance undertakings, UCITs, AIFs, etc.

¹⁴⁶ The average annual value of financial transactions is calculated in accordance with Art. 2 (3) EU 11 FTT Proposal (e.g. 10 % of the taxable amount for derivatives and the taxable amount for other transactions).

¹⁴⁷ These include some activities referred to in Annex I to Directive 2006/48/EC (*i.e.* CRD III, now replaced by CRD IV) (essentially deposit-taking, lending, financial leasing and extending guarantees), trading in financial instruments for own account or in the name of customers, acquisitions of holdings in undertakings, and participation in or issue of financial instruments and the provision of services related thereto.

¹⁴⁸ O. HENKOW, "The Commission's Proposal for a Common System of Financial Transaction Tax: A Legal Appraisal", *EC Tax Review* 2012, 4-6.

2.1.2.2 Transaction party

64. FTT may be chargeable on both parties or the purchaser or seller in particular. This distinction is relevant for two reasons. Firstly, suppose that a taxable person sells shares to an exempt or excluded party (e.g. a clearing house, see no. 78). A FTT that applies to transaction parties in general will still be chargeable on the non-exempt party, whereas a FTT limited to the purchaser will not be chargeable at all. The second reason is that the choice made usually determines who incurs tax liability. However, other parties may have to withhold the relevant sums or be jointly and severally liable. According to established economic literature, however, ultimate tax incidence will not be determined by legal liability but depends on supply and demand elasticities.¹⁴⁹

65. Most stamp duties only charge the purchaser of chargeable securities (e.g. Finland, Ireland, Italy, Poland, Romania, Singapore and UK).¹⁵⁰ The underlying idea for UK SDRT is that the purchaser has a clear incentive to comply, since legal enforceability often depends on payment of the tax (see no. 134-135).¹⁵¹ As noted above, French FTT takes another approach and taxes the *acquisition* of shares. Consequently, the determination of a taxable person is not necessary. An example of a FTT imposed solely on the seller is the abolished Greek transaction duty.¹⁵² Some countries tax both transaction parties (e.g. Belgium, EU 11 and Sweden*).¹⁵³ When the tax is not split between the parties, this implies that the effective tax rate on each transaction will be double (e.g. 0.2% for EU 11 FTT). One benefit of charging all parties to the transaction is that tax authorities can potentially cross-check tax returns, which increases the risks connected to tax evasion.¹⁵⁴

66. Derivatives transactions pose some problems of construction. Where the use of the notions buyer and seller might still be possible for derivatives conceived as contracts for the sale of financial instruments (e.g. options and futures/forwards), this does not apply to other types (swaps). Generally, FTTs on the conclusion of a broad range of derivatives apply to both parties (e.g. EU 11 and Italy). FTTs on specific derivatives types do have the option of being more concrete. French FTT on sovereign CDSs, for instance, is applicable to the protection buyer.¹⁵⁵ The same interpretation difficulties arise with relation to spot FX transactions where currencies are exchanged and parties act

¹⁴⁹ E.g.: When demand elasticities are high, the seller is more likely to bear the ultimate tax burden by asking a lower price: J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 13.

¹⁵⁰ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 558, 605, 657, 669, 708 and 722; V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 53.

¹⁵¹ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 16.

¹⁵² EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 585.

¹⁵³ Art. 122 (1) WDRT (BE); Art. 10 (1) EU FTT Proposal; B. CORTEZ and T. VOGEL, "Financial Transaction Tax", see *supra* note 43, 25.

¹⁵⁴ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 13-14.

¹⁵⁵ *I.e.*: the party who will benefit when a credit event occurs (e.g. when the issuing government defaults on the underlying debt); Art. 235 ter ZD ter CGI (FR).

simultaneously as buyer and seller. Accordingly, the inoperative Belgian CTT charges both parties.¹⁵⁶ There would be no issue, however, when the CTT is limited to transactions in one currency. In that case, the purchaser of the chargeable currency could be the taxable person. Brazilian IOF charges purchases of real by non-residents and sales of real by residents.¹⁵⁷

2.1.2.3 Exemptions

67. FTTs may grant exemptions to specific qualifying persons. As stated above, this does not necessarily entail that the transaction will not attract FTT on the counterparty leg. Exemptions for specific persons largely coincide in function and rationale with the exemptions for instruments and transactions referred to above.

68. EU 11 FTT grants an exemption to Member States, including debt agencies when concluding transactions in the framework of their function.¹⁵⁸ Other FTTs exempt the national government (e.g. Singapore).¹⁵⁹

69. Some exempt (managers of) collective investment undertakings (e.g. Belgium and Switzerland).¹⁶⁰ Therefore, investments within the fund are exempted. Transfers of units in the undertaking may still be taxable as seen above.

70. EU 11 FTT is imposed on pension funds. Some fear that this will result in the FTT tax burden falling largely on pensioners, instead of financial institutions.¹⁶¹ It is material to note that many important FTTs do not exempt pension funds (e.g. Brazil, Taiwan and UK).¹⁶² Some, however, do (e.g. Belgium and Italy for all and Switzerland for foreign pension funds).¹⁶³ Exempting pension funds would safeguard pensioners, but also severely reduce tax revenue and create leeway for avoidance.¹⁶⁴

¹⁵⁶ Art. 10 WDRT (BE).

¹⁵⁷ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 38.

¹⁵⁸ Art. 3 (2) (c) EU 11 FTT Proposal.

¹⁵⁹ Section 36 (a) Stamp Duties Act (Chapter 312) (2006 revised edition) (SG).

¹⁶⁰ Art. 126/1 (2) WDRT (BE); EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 8, 10.

¹⁶¹ E.g.: J. ANTHONY *et al.*, "FTT: review and assessment", see *supra* note 79, 20. For arguments in favour of taxing pension funds see J. GRAY, S. GRIFFITH-JONES and J. SANDBERG, "No Exemption: the Financial Transaction Tax and Pension Funds", Network for Sustainable Financial Markets Report, 2012, 8 p., http://www.sustainablefinancialmarkets.net/wp-content/uploads/2012/12/No_Exemption.pdf (hereafter: J. GRAY *et al.*, "Pension Funds").

¹⁶² Oxera argues that UK stamp duty and SDRT are strongly detrimental to pension savings: Oxera, "Stamp duty: its impact and the benefits of its abolition", 2007, iii, www.oxera.com/Latest-Thinking/Publications/Reports/2007/Stamp-duty-its-impact-and-the-benefits-of-its-abo.aspx (hereafter: Oxera, "Stamp Duty"). J. GRAY *et al.*, "Pension Funds", *supra* note 161, 6.

¹⁶³ Art. 126/1 (2) WDRT (BE); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 58-59; J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 23.

¹⁶⁴ A substantial part of UK SDRT revenue flows from pension funds: Oxera, "Stamp Duty", see *supra* note 162, iii.

Since EU 11 FTT applies to transactions in a broad range of instruments, including government debt, even relatively conservative pension funds will bear a part of the tax burden. More aggressive pension funds with a higher portfolio turnover rate will, however, attract more FTT.¹⁶⁵ The impact of a European FTT on pension funds will of course be much more substantial for systems in which pension pre-funding and pension funds play an important role.¹⁶⁶

71. Belgium, unlike most FTTs, provides a blanket and explicit exemption for the proprietary trading of several financial institutions (e.g. credit institutions, investment firms and insurance undertakings).¹⁶⁷ Accordingly, Belgian stock exchange tax is clearly a tax on retail investors and non-financial undertakings. Swiss stamp duty exempts foreign banks and securities dealers.¹⁶⁸

2.1.2.4 Intermediary relief and relief for central counterparties

72. FTTs may furthermore provide for specific exemptions for parties interposed in the transaction chain, *i.e.* financial intermediaries and central clearing and settlement institutions. This exemption is aimed at preventing tax cascading. Moreover, these entities do not operate speculatively, provided that they are effectively acting as intermediaries, which is difficult to ascertain.

73. Financial intermediaries may interfere in the conclusion and settlement of financial transactions as brokers. Brokers act either in the name and for the account of their clients (*cf.* disclosed agency) or in their own name, but for the account of their clients (*cf.* undisclosed agency). Legal consequences of different types of intermediation and market practices vary between jurisdictions. Belgian intermediaries, for example, often act as "commissionaires", *i.e.* they act in their own name, but for the account of their clients. As a consequence, the counterparty has no knowledge of the identity of the principal. Furthermore, it is generally accepted that, although no direct contractual link exists between principal and counterparty under Belgian law, ownership is directly transferred to the principal.¹⁶⁹ It may be argued that the close connection between the definition of chargeable transactions and the transfer of ownership or property interest under national law implies that a transaction in which a broker is legally acting for the account of a client will only attract a single FTT charge in many jurisdictions.¹⁷⁰ EU 11 FTT takes a different approach. Financial institutions who act

¹⁶⁵ EC, "Impact Assessment EU 11 FTT", see *supra* note 43, 36.

¹⁶⁶ J. GRAY *et al.*, "Pension Funds", *supra* note 161, 2.

¹⁶⁷ Art. 126/1 (2°) WDRT (BE).

¹⁶⁸ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 729.

¹⁶⁹ I. SAMOY, *Middellijke vertegenwoordiging*, Antwerp-Oxford, Intersentia, 2005, 228-230 and 322-323.

¹⁷⁰ Italian FTT explicitly confirms that for both disclosed and undisclosed agency, ownership is deemed to be transferred once, namely in the hands of the ultimate owner: V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 50. See also Belgian VAT legislation which explicitly institutes the legal fiction that a commissionaire acts as buyer/seller towards the third counterparty and seller/buyer towards the

in the name or for the account of a principal will only escape the FTT charge if that principal itself is a chargeable financial institution.¹⁷¹ Therefore, financial institutions will be subject to FTT when providing brokerage services to non-financial investors.

74. Financial intermediaries, may, however, also act on their own account, *i.e.* as a principal in the legal sense. Examples of such intermediaries are dealers and market makers. Dealers match mirrored intentions in the markets. This business model is widespread in the FX and OTC markets.¹⁷² In addition to trading with clients, interdealer markets may be substantial in volume. This implies that one economic transaction between end investors often involves multiple interdealer transactions. Market makers operate similarly, but have the function of providing liquidity in specific markets. These entities are usually connected to trading venues and post two-way quotes (*i.e.* bid and ask prices), thereby expressing their willingness to trade in a specific instrument on a continuous basis.¹⁷³ Since these entities operate as principals, transactions will generally attract FTT.

75. Exemptions for intermediaries have one important disadvantage: they usually create loopholes which allow financial institutions to avoid the tax. This is caused by the difficulties encountered when attempting to distinguish transactions in the framework of, on the one hand, intermediation and, on the other, proprietary trading (*i.e.* transactions concluded on own account without any link to the client business). Trading on behalf of customers and market making activity are often only a part of the financial institution's overall business. Certain transactions concluded by the institution may contain elements of both or their purpose may not be fully clear at time of conclusion (e.g. when the institution acquires an inventory to cover existing, but also expected client orders).¹⁷⁴ As stated above, Belgian stock exchange tax does not even attempt to make a distinction and exempts all trading on own account by financial intermediaries. Irish stamp duty and UK SDRT both grant intermediary relief and have several features in common.¹⁷⁵ UK SDRT exempts members of certain trading venues or, more

principal for the purposes of VAT: Art. 13 Code of the VAT (BE). Belgian CTT does the same: Art. 4 (par 4) Law on foreign exchange taxation.

¹⁷¹ Art. 10 (1) and (2) EU 11 FTT Proposal.

¹⁷² J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 19 and 33. See also I. SAMOY, *Middellijke vertegenwoordiging*, Antwerp-Oxford, Intersentia, 2005, 230 [note 643].

¹⁷³ See note 182.

¹⁷⁴ There are clear similarities with the discussion on the ring-fencing of banks' retail activities and, more specifically, the inclusion of trade on behalf of customers in the retail bank and the exclusion of proprietary trading in the Volcker Rule. For more information and the example given above: R.R. CHATTERJEE, "Dictionaries Fail: The Volcker Rule's Reliance on Definitions Renders It Ineffective And A New Solution Is Needed To Adequately Regulate *Proprietary trading*", *International Law & Management Review* 2011, 53 *et seq.*

¹⁷⁵ HMRC, "Stamp Duty and Stamp Duty Reserve Tax: Intermediary and Stock Lending Reliefs - FA 2007 Changes", 2007, 1-5, www.hmrc.gov.uk/so/sdrt-guidance-mifid.pdf (hereafter: HMRC, "Intermediary Relief"); Revenue Commissioners, "Finance Act 2007 - Stamp Duty on Transfers of Irish Securities: New Reliefs for Certain Market Participants - Intermediary Relief - Central Counterparty Relief", August 2007, 2 *et seq.*, www.revenue.ie/en/practitioner/law/notes-for-guidance/stamp-duty/archive/2007/guidance-note-stamp-duty-on-transfers-of-irish-securities.pdf (hereafter: Revenue Commissioners, "Intermediary Relief").

generally, persons authorized to execute orders on behalf of clients or on own account under the laws of a EEA state (e.g. credit institutions and investment firms) who are recognized by HMRC.¹⁷⁶ The former are exempted in relation to transactions in shares regularly traded on the regulated market, MTF or recognized foreign exchange of which they are a member, whereas the latter are more generally exempted for transfers of shares regularly traded on such trading venues. Recognized intermediaries are persons who carry on a *bona fide* business of dealing in securities and do not carry on an "excluded business" (e.g. investment management, managing a pension fund or collective investment scheme, insurance, etc.).¹⁷⁷ Once the person carries out an excluded business, relief is not available for any transaction. In the opposite case, however, relief will have full effect for all qualifying transactions: in practice all securities transactions.¹⁷⁸ The fact that a broad range of financial institutions qualifies for relief, the very broad definition given to "dealing in securities" and the restrictive interpretation of the notion excluded business lead to a situation where financial institutions can widely benefit from the relief, even for proprietary trading, which therefore offers significant avoidance possibilities.¹⁷⁹

76. Italy¹⁸⁰ and France¹⁸¹ provide for a market maker exemption which refers (Italy) or is similar (France) to the market making activities notion in the Short Selling Regulation ("SSR").¹⁸² Accordingly, the exemption covers both market makers and dealers, but only extends to activities covered by the definition.¹⁸³ Chargeable transactions outside of this activity concluded by the same entity are therefore not exempted. Firstly, liquidity provision on and outside trading venues (traditional market making activity) is covered by the exemption. Secondly, dealers will be exempt when fulfilling orders by clients or in response to clients' request to trade if this is part of their usual business. French tax authorities have clarified that the relevant entity should be able to demonstrate a link between a

¹⁷⁶ HMRC, "Intermediary Relief", *supra* note 175, 1-3.

¹⁷⁷ HMRC, "Stamp Taxes Manual", see *supra* note 17, 261.

¹⁷⁸ This is different for Irish stamp duty, where intermediaries are still allowed to carry on excluded business. Transactions within this framework will not benefit from relief: Revenue Commissioners, "Intermediary Relief", *supra* note 175, 6.

¹⁷⁹ HMRC, "Stamp Taxes Manual", see *supra* note 17, 261. "Dealing in securities" simply requires profits to be made which, if made in the UK, would be in scope of Case 1 Schedule D of the UK corporation tax (profits from trades). Accordingly, even entities not engaged in trading on behalf of clients qualify.

¹⁸⁰ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 57-58. Since reference is made to the Regulation, market makers should submit a request for recognition in relation to certain instruments to the Italian Companies and Stock Exchange Commission (CONSOB) pursuant to Resolution CONSOB No. 18494, 13 March 2013, www.consob.it/mainen/documenti/english/resolutions/res18494.htm.

¹⁸¹ Art. 235 ter ZD (II) (3) CGI (FR).

¹⁸² Art. 2 (1) (k) Regulation Parl., No 236/2012, 14 March 2012 on short selling and certain aspects of credit default swaps, *OJ. L.* 24 March 2012, 86, 1 (hereafter: Short Selling Regulation). For more information see ESMA, "Guidelines: Exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps", 2013/74, 24 p., www.esma.europa.eu/system/files/2013-74.pdf (hereafter: ESMA, "Guidelines: market making activities").

¹⁸³ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 58; Art. 235 ter ZD (II) (3) CGI (FR).

client's request and the transaction on own account.¹⁸⁴ Transactions anticipating demand are therefore not exempted. This could be different for Italian FTT, since ESMA seems to allow anticipatory non-speculative "hedging" under the market maker exemption in SSR.¹⁸⁵ Finally, hedging transactions related to these activities above are exempted (e.g. a dealer purchasing securities to hedge a contract concluded on the request of a client).¹⁸⁶

77. Another illustration of the avoidance potential of intermediary exemptions is the "member exemption" previously granted by South African STT. It came to the attention of the tax authorities that market participants were using the exemption to avoid the tax on transactions used to "hedge" CFD and other equity-linked derivatives. Dealers would conclude CFDs with clients and subsequently enter into back-to-back transactions with exempted members who would buy the underlying securities tax-free. After an eventful period, the legislator finally decided to put an end to the member exemption, but provided for a lower tax rate to safeguard liquidity.¹⁸⁷ Avoidance risk primarily exists in relation to dealing activity and rather opaque anticipatory or "hedging" transactions. Risk is lower for market making activity in which clients place orders in response to quotes posted by the market maker. However, such a limited exemption would not necessarily safeguard the business model when building up reserves is too costly. Moreover, it would require a clear demarcation of this activity conforming to the market rules of the relevant trading venue as compared to other dealing-like activity. EU 11 FTT currently provides for no exemption for intermediaries acting as principals.

78. Exempting central counterparties ("CCPs"), however, bears little risk. A CCP is interposed as counterparty to two clearing members, who are or act for the original counterparties, often through the legal act of novation.¹⁸⁸ This implies that an additional FTT charge may arise on both of the transactions. The systemic function of CCPs in financial market infrastructure is generally welcomed by policy makers. Additional tax cascading resulting from the use of CCPs would lead to disincentives for centralized settlement. Moreover, avoidance is much less likely.¹⁸⁹ EU 11 FTT, France, Italy and the UK all exempt the operation of centralized clearing and settlement systems to some extent.¹⁹⁰ Italy

¹⁸⁴ PwC, "French FTT", see *supra* note 130, 6-8.

¹⁸⁵ ESMA, "Guidelines: market making activities", see *supra* note 182, 15.

¹⁸⁶ It is expected that this will not be possible for transactions hedging OTC derivatives: V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 57.

¹⁸⁷ M. WATT, "South African tax ruling may just be stay of execution, brokers warned", *Risk magazine*, 3 October 2011, www.risk.net/risk-magazine/feature/2112197/south-african-tax-ruling-stay-execution-brokers-warned; National Treasury Republic of South Africa, "Budget Review 2012", 22 February 2012, 58, www.treasury.gov.za/documents/national%20budget/2012/review/FullReview.pdf.

¹⁸⁸ BIS, "Recommendations for Central Counterparties", March 2004, 11, www.bis.org/publ/cpss61.pdf.

¹⁸⁹ E.g.: for CCPs authorized under EMIR, strict prudential and operational requirements exist. Moreover, CCPs are only allowed to invest in cash or highly liquid financial instruments: Art. 47 (1) Regulation Parliament No. 648/2012, 4 July 2012 on OTC derivatives, central counterparties and trade repositories, *OJ. L.* 27 July 2012, 201, 1 (hereafter: EMIR).

¹⁹⁰ Art. 3 (2) (a) and (b) EU 11 FTT Proposal; Art. 235 ter ZD (II) (2) CGI (FR); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 57. In the UK, the Treasury may adopt specific regulations to

provides for a more generic exemption, which will, nonetheless, be limited to CCPs in practice: it is limited to those cases in which price, total number of instruments and settlement date of the respective sale and purchase transaction coincide.¹⁹¹ The EU 11 FTT exemption, however, could be less far-going than one would expect. The exemption stretches out to CCPs (as defined under EMIR) and (International) Central Securities Depositories ("[I]CDSs") where exercising their proper function.¹⁹² However, the clearing members, when transacting with the CCP as principals, will still be subject to the charge.¹⁹³ Insofar as chargeable non-cash collateral is posted by the clearing member by means of a transfer of ownership, CCP collateral management may also attract FTT. It may be argued that collateral and margin management are a part of the function of CCPs and are therefore exempted on their side of the transaction.¹⁹⁴

79. In their draft treaty, the Leading Group proposed the adoption of a liberalizing electronic FTT tag.¹⁹⁵ When FTT is paid on a particular transaction and electronic tag is generated and all intermediaries and providers of financial market infrastructure further down the chain are exempt (see also no. 135).

2.1.2.5 Transactions within groups

80. Some FTTs fully exempt or exclude transactions between group entities (*i.e.* legal persons among whom a relationship of direct or indirect control exists) from the FTT scope (France and Italy).¹⁹⁶ Intra-group relief is not available under SDRT. Parties will have to draw up a document and meet several conditions to benefit from intra-group relief under ordinary stamp duty.¹⁹⁷

81. EU 11 FTT explicitly provides for intra-group transactions in order to limit avoidance possibilities, taxing all transfers of "*the right to dispose of a financial instrument as owner and any equivalent operation implying the transfer of risk associated with the financial instrument*" which would not be captured by the purchase and sale notion.¹⁹⁸ The concept "entities of a group" is not

exempt clearing houses and their members: see 117 Finance Act 1991 c.31 s.116 and 117 (UK) (hereafter: FA 1991).

¹⁹¹ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 57.

¹⁹² Art. 3 (2) (a) and (b) *juncto* 2 (1) (9) EU 11 FTT Proposal.

¹⁹³ M.J. PETERS, "*Capita Selecta* Financial Transaction Tax, *supra* note 68, 27-28.

¹⁹⁴ The Explanatory Memorandum explains that the exemption is not applicable should CCPs and (I)CSDs engage in trading activity. Collateral and margin management, however, are clearly seen as a pivotal function of CCPs, for instance in EMIR. See Explanatory Memorandum EU 11 FTT, see *supra* note 42, 10.

¹⁹⁵ Leading Group, "Tax on Financial Transactions", see *supra* note 28, 24.

¹⁹⁶ Art. 235 ter ZD (II) (5) CGI (FR); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 56.

¹⁹⁷ HMRC, "Relief from Stamp Duty in respect of documents effecting intra-group transfers of stock or marketable securities", www.hmrc.gov.uk/sd/reliefs/intra-group-relief.htm.

¹⁹⁸ Art. 2 (2) (b) EU 11 FTT Proposal.

defined, which thus leaves legal uncertainty. This might be limited, however, since the purchase and sale notion is very broad and might already cover most transactions within groups.¹⁹⁹ As noted before, entities performing functions of centralized treasury management are at risk of being qualified as financial institutions. The FTT's impact may thus not be limited to financial groups. In the UK, such entities will generally be excluded from the possibility of attaining intermediary relief.²⁰⁰

2.1.2.6 Conclusion

82. The greatest difference between post-crisis FTTs and traditional STTs is that the former tax financial institutions, whereas the latter usually provide for broad or even blanket exemptions for financial services firms and are clearly taxes directed at non-financial investors. For a steering FTT not to target the financial sector would be quite absurd, since it are exactly these institutions who conduct the bulk of trading which is seen as harmful. In this respect, EU 11 FTT is conceived as a "bank tax" and directed at the financial sector. Exemptions play largely the same role as those for certain instruments and transactions and entail the same dangers. Again, it is clear that EU 11 FTT has chosen to limit avoidance, rather than alleged distortions (e.g. discouraging risk diversification through taxation of collective investment, burdening pensioners, etc.). It should not be forgotten, however, that traditional STTs and French and Italian FTT do target retail investors and enterprises. For these transactions, the difference with EU 11 FTT, which taxes brokerage services for non-financial persons, may not be that large. Italian FTT, however, does exempt some entities (e.g. pension funds). A further important difference between EU 11 FTT and other FTTs, pre- or post-crisis, is that EU 11 FTT has no mercy whatsoever for financial firms acting as principals when providing intermediary services to clients. The Commission clearly wants financial firms to adhere to the traditional brokerage business model (see no. 178). This is different from French and Italian FTT, which do grant an exemption, but attempt to limit avoidance opportunities. While the EU 11 FTT's approach is still defensible for dealing activities in general, the author feels that the EU 11 FTT goes too far in its disregard for the benefits of liquidity provided by market makers for the functioning of secondary markets. A very strict market maker exemption, only extending to actual market making activity in the traditional sense by liquidity providers that have concluded a contract with the relevant trading venue to this purpose, may still be possible without too big of an avoidance risk.

¹⁹⁹ HENKOW argues that, since the Proposal relies heavily on other EU financial market regulation, the definition employed herein should be used: *i.e.* "entities of a group" should be interpreted as encompassing the separate companies and not internally the head office and different branches. See O. HENKOW, "FTT Proposal", see *supra* note 133, 12.

²⁰⁰ The business of wholly or mainly providing services to persons with which the firm is connected is an excluded business. See HMRC, "Stamp Taxes Manual", see *supra* note 17, 270.

2.1.3 Territorial scope

2.1.3.1 Connecting factors: general

83. Tax avoidance by means of relocation and migration of trading activity to non-taxing jurisdictions is a serious threat. The territorial nexus for application is an essential instrument and will determine to what extent a FTT is imposed in relation to transactional elements or parties located outside the tax territory. Territorial application is usually based on one or more of three principles: the issuance, place of transaction or residence principle.²⁰¹

84. The issuance principle implies taxation of certain instruments which were issued or registered within the taxing jurisdiction's territory. This is the approach taken by many traditional stamp duties (e.g. Cyprus, Singapore, South Africa and UK)²⁰² and the more recent French and Italian FTTs²⁰³. "Issued within the territory" generally means that securities are issued by corporate entities with registered office in the relevant jurisdiction. The issuance principle makes migration of trading activity theoretically useless, given that trading in chargeable securities will usually be taxed globally. The principle, however, is vulnerable to avoidance by means of substitution. Firstly, market participants may seek to simply cease trading in the instruments concerned and switch to foreign securities. Secondly, parties could have recourse to non-taxable instruments referencing the economic value of the chargeable security: e.g. depositary receipts or derivatives. Depositary receipts and national equivalents²⁰⁴ are negotiable instruments incorporating rights to an underlying foreign share. The foreign shares are often held by a custodian or holding entity (e.g. bank) which issues the depositary receipts.²⁰⁵ These instruments are therefore not necessarily issued by an entity established in the same jurisdiction as the issuer of the shares and may escape the FTT charge. To foreclose this avoidance opportunity, jurisdictions might give a flexible interpretation to the issuance principle, extending it to negotiable instruments that reference chargeable instruments (e.g. France and Italy).²⁰⁶ EU 11 FTT explicitly extends the issuance principle to depositary receipts, but only when these are issued "*with*

²⁰¹ See EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 7, 4.

²⁰² EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 519; Section 35 (d) Stamp Duties Act (Chapter 312) (2006 revised edition) (SG); Section 2 (1) (a) Securities Transfer Tax Act 2007 (ZA); FA 1986 c.41 s.99 (UK).

²⁰³ Art. 235 ter ZD (I) (par 3) CGI (FR); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 49.

²⁰⁴ Examples of depositary receipts are American Depositary Receipts (ADRs). Other jurisdictions have methods by which shares may be held by an entity "transforming" them into certain certificates or interests: e.g. the Dutch administrative office (*administratiekantoor*) (see R. KABIR, "Corporate Financing in the Netherlands" in L. RENNEBOOG (ed.), *Advances in Corporate Finance and Asset Pricing*, Amsterdam, Elsevier, 2006, 369) and UK depositary interest (see HMRC, "Stamp Taxes Manual", see *supra* note 17, 256).

²⁰⁵ HMRC, "Stamp Taxes Manual", see *supra* note 17, 280.

²⁰⁶ Art. 235 ter ZD (I) (par 3) CGI (FR); V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 50.

the essential purpose of avoiding tax on transactions in the underlying security [...] in case a tax benefit would otherwise arise" and thus as part of anti-avoidance measures.²⁰⁷

85. This approach, however, may very well raise enforcement costs, bearing in mind the difficulties accompanying FTT collection on trading in foreign markets. For this reason, UK SDRT exempts transfers *within* depositary receipt schemes and clearance services.²⁰⁸ As compensation for the revenue lost, a higher charge of 1,5 % ("season ticket") on the issue or transfer of chargeable securities into depositary receipt schemes or clearance services was instituted.²⁰⁹ As a consequence of judgments by the CJEU and a UK Court²¹⁰ on the compatibility with the CDD, however, HMRC has indicated that it will not enforce the levy of stamp duty on the original issuance of chargeable securities into these schemes, but will in relation to transfers not in the course of primary market transactions.²¹¹ The charge has therefore lost a substantial part of its significance.

86. Derivatives, when not in scope, may be used to avoid STTs (see no. 38). When FTTs, based on the issuance principle, target derivatives linked to chargeable securities, the issuance principle could be interpreted as relating to the underlying security (e.g. Italy).²¹² However, issuance is often a notion poorly suited for derivatives. Derivatives contracts as such are not issued. They may be generated on a trading venue (e.g. futures), however, but this would relate more closely to the place of transaction principle. An interpretation of issuance as extending to the underlying is thus possible in relation to securities which themselves are issued. It would, however, not be possible for other instruments or values (e.g. commodities, interest rates, etc.). It seems that the EU 11 FTT has excluded OTC derivatives from the application of the issuance principle for these reasons.²¹³ The proposal, however, is silent on derivatives traded on organized platforms. The question thus remains whether the above mentioned broad interpretation is to be used where possible, in which case the territorial scope of the EU 11 FTT would expand drastically.²¹⁴ Clarification is necessary.

87. The place of transaction principle entails that transactions somehow localized within the jurisdiction become subject to FTT. This requires some element in the transaction process which can

²⁰⁷ Art. 14 EU 11 FTT Proposal.

²⁰⁸ FA 1986 c.41 s.90 (5) and 99 (6) (UK). Securities could be entered into foreign clearance services, *i.e.* held by one entity and with beneficial ownership represented by book-entries. Similar enforcement issues exist.

²⁰⁹ HMRC, "Stamp Taxes Manual", see *supra* note 17, 279.

²¹⁰ CJEU C-569/07, *HSBC Holdings plc and Vidacos Nominees Ltd v HMRC*, E.C.R. 2009, I, 9047; First Tier Tribunal (Tax Chamber) UK 28 February 2012, no. TC/2009/16584, para 320 *et seq.*, www.bailii.org.

²¹¹ See HMRC, "SDRT - HSBC Holdings PLC and the Bank of New York Mellon Corporation v HMRC: First-Tier Tax Tribunal decision - further announcement", www.hmrc.gov.uk/so/sdrt-hsbc-holdings.pdf (hereafter: HMRC, "HSBC v HMRC").

²¹² V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 53-54.

²¹³ Art. 4 (1) (g) and 4 (2) (c) EU 11 FTT Proposal; J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 228-229.

²¹⁴ For a brief legal analysis: J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 228-229.

be confined to one location. Therefore, FTTs may be imposed on transactions concluded on domestic trading venues (e.g. Italian tax on HFT), cleared and settled by a domestic CCP and/or CSD and reported to or registered with a domestic entity (e.g. trading repository).²¹⁵ FTTs could also apply to transactions when a domestic financial intermediary is involved as a party or intermediary. This is the approach taken by Swedish* and Swiss FTT.²¹⁶ Belgian stock exchange tax is applicable to "*transactions concluded or executed in Belgium*".²¹⁷ Several market participants seem to interpret this provision as requiring that the relevant investment and money accounts are held in Belgium.²¹⁸ Given that the Belgian tax is only applicable when a financial intermediary is involved in the transaction, the practical situation is very close to the Swiss one. Only the use of a Belgian intermediary or the domestic branch of a foreign one leads to taxation. Although this interpretation is by no means generally accepted, the Belgian example shows how important clear and concrete provisions on territorial application are, especially in the EU context of free provision of services.

88. The place of transaction principle has some apparent weaknesses. Firstly, it follows from the observations above that its application is very difficult with relation to transactions with a highly decentralized completion process (e.g. bilaterally cleared and settled OTC derivatives).²¹⁹ Furthermore, it is susceptible to trading migration as the Swedish and, to a lesser extent, the Belgian example show (e.g. the use of foreign brokers). The question remains whether the advantages of trading migration will offset its costs (e.g. migration to foreign CCPs or exchanges). Secondly, the place of transaction principle may lead to unfair revenue allocation between countries, since global trading is highly centralized in a number of market places. This would make some revenue apportionment mechanism between countries, possibly based on GDP or financial sector size, politically necessary.²²⁰

89. FTTs may finally also tax chargeable transactions concluded by parties who have their residence or are established within the taxing jurisdiction. This leads to taxation of transactions concluded worldwide by companies incorporated domestically and, possibly, transactions concluded

²¹⁵ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 59 and 60; Cf. EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 7, 7-8.

²¹⁶ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 8, 8 and 9: this is generally seen as one of the main flaws of the Swedish FTT.

²¹⁷ Art. 120 WDR (BE).

²¹⁸ See e.g.: J. REYNS, "Prijsbreker omzeilt beurstaks", *De Standaard*, 10 April 2014, www.standaard.be/cnt/dmf20140409_01062026; J. STEENACKERS, "De Beurstaks: inhouden of niet?", *Knack*, 6 July 2012, <http://moneytalk.knack.be/economie/geld-en-beurs/dossiers/online-brokers/de-beurstaks-inhouden-of-niet/article-4000133719890.htm>; I. DE WITTE, "Belegger betaalt geen beurstaks bij tal van buitenlandse brokers", *De Tijd*, 17 March 2012, 27.

²¹⁹ See, however, no. 118.

²²⁰ S. SCHULMEISTER, M. SCHRATZENSTALLER and O. PICEK, "A General Financial Transaction Tax - Motives, Revenues, Feasibility and Effects", WIFO, 2008, 3, www.wifo.ac.at/jart/prj3/wifo/main.jart?content-id=1298017551022&publikation_id=31819&detail-view=yes.

by domestic branches of foreign companies.²²¹ Belgian stock exchange tax, for instance, only applies to Belgian residents.²²² In contrast with the issuance and place of transaction principles, the residence principle is more neutral as to the type of transaction concluded and can be applied to transactions posing interpretative or practical problems under the other principles (e.g. bilaterally cleared OTC derivatives).²²³ However, tax collection may still pose some problems.²²⁴ It may also be employed by countries with relatively large financial sector turnover, but low activity on the national marketplace (*i.e.* exchanges). The residence principle, however, provides leeway for tax avoidance. Market participants may want to relocate their businesses abroad, transform foreign branches into subsidiaries, migrate trading activity to foreign subsidiaries, etc.²²⁵ Accordingly, there is a risk that retail investors and businesses without branches or subsidiaries in non-taxing jurisdictions (e.g. SMEs) will bear the heaviest burden.

90. CTTs could equally rely on one or more of these principles. The issuance principle may then be construed as relating to the currency issued by the taxing jurisdiction. Belgian CTT provides for an inclusive "cascade" of possible connecting factors: (i) residence of one of the parties or intermediaries in Belgium (residence and place of transaction), (ii) settlement, negotiation or orders given within Belgium (place of transaction) and (iii) one of the currencies is Belgian legal tender (issuance).²²⁶

91. Based on the foregoing, it may be concluded that each of the three principles leaves avoidance opportunities to a certain extent intact. Therefore, some countries adopt a combination. EU 11 FTT, discussed below, is the prime example. FTTs with strong extraterritorial elements are harder to avoid. The practical results, however, will depend largely on the extent to which the tax can be enforced outside the national territory (see no. 137-139).

Table III - Territorial application of selected FTTs

	Issuance	Place of transaction	Residence
Belgium (STT)	-	<i>"transactions concluded or executed in Belgium"</i> : interpretation uncertain	only Belgian residents (non-residents are exempted)

²²¹ E.g.: EU 11 FTT and Greece* (see Table III).

²²² Art. 126/1 (2) WDRT (BE).

²²³ EC, "Impact Assessment EU 11 FTT", see *supra* note 43, 39.

²²⁴ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 7, 6.

²²⁵ J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 232. Relocation may be limited as concerns HFT. The business model requires trading servers to be located as near as possible to the relevant trading venue: S. SCHULMEISTER, "Strong Pros, Weak Cons", see *supra* note 49, 89.

²²⁶ Art. 5 Law on foreign exchange taxation. The Law provides that an order of priority is given to the connecting factors by Royal Decree.

France (general FTT)	issuance by company with registered office in France	-	-
France (HFT)	-	-	HFT by companies established in France or domestic branches of foreign companies for trade in equity securities
France (CDS)	"naked" CDS on sovereign debt of EU Member State	-	physical persons with domicile and companies established in France and domestic branches of foreign companies
Greece*	tax on transfer Greek listed shares: everyone	-	tax on transfer foreign shares: only Greek residents (includes Greek branches of foreign entities)
Italy (general FTT)	- issuance by company with registered office in Italy - derivatives: application of issuance principle to underlying instrument - securities representing chargeable securities (depository receipts)	-	-
Italy (HFT)	-	HFT on Italian financial markets (regulated markets and MTFs authorized by CONSOB) (no	-

		application of issuance principle)	
South Africa	securities issued by companies incorporated, established or formed inside South Africa	securities issued by foreign companies, but listed on a licensed exchange	-
Sweden*	when transaction parties foreign: only applicable if security registered in Sweden	generally: only applicable if Swedish brokerage was used	see issuance
Switzerland	-	Swiss securities dealer involved as intermediary or party	exemptions for certain non-residents (e.g. states, central banks and foreign banks and securities dealers)
UK	- securities in UK companies or foreign companies with a register in the UK - trading in depositary receipts on UK securities excluded - "season ticket" on transfer to depositary receipt or clearance schemes now largely inoperative	-	-

Sources²²⁷

²²⁷ **BE:** Art. 120 *juncto* 126/1 (2) WDRT. **FR:** Art. 235 ter ZD (I), ZD bis (I) and ZD ter (I) CGI; **GR:** EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 585-586. **IT:** V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 49, 50, 53, 59 and 60. **ZA:** Sections 1 and 2 (1) Securities Transfer Tax Act 2007. **SE:** J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 17. **CH:** EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 729-730. **UK:** HMRC, "Stamp Taxes Manual", see *supra* footnote 17, 242, 251; HMRC, "HSBC v HMRC", see *supra* footnote 211.

2.1.3.2 EU 11 FTT territorial scope: establishment, contagion effect and economic substance defence

92. The territorial application of the EU 11 FTT is based on the notion of establishment. All financial institutions which are established within a participating Member State and enter into financial transactions are subject to EU 11 FTT in that Member State. Contrary to what one might expect, the establishment criterion is by no means synonymous to the residence principle. The first Commission proposal for a EU-wide FTT already included multiple elements of the residence and place of transaction principles and was replaced by the EU 11 FTT proposal, which adds the issuance principle²²⁸ and, therefore, incorporates a combination of all three possible connecting factors. For the FTT charge to arise, at least one party to the transaction should be established within the EU 11 area and at least one financial institution established within this area should be a party or intermediary to the transaction.²²⁹ Article 4 of the EU 11 FTT Proposal lists a series of conditions for the establishment of financial institutions. Fulfilment of multiple conditions in different participating Member States will not lead to double taxation, since the first condition to be fulfilled chronologically determines establishment.²³⁰ A first series of conditions relates to the authorization of a financial institution to conclude the taxable financial transactions. These are an application of the place of transaction principle (trading on EU platforms requires authorization).²³¹ A second set relates to the residence of the financial institution and embodies the residence principle.²³² The third condition introduces the "counterparty principle" and will be discussed below. The fourth, newly added, condition institutes the issuance principle, with an exception for OTC derivatives.²³³

93. Article 4 (1) (f) of the EU 11 FTT proposal introduces the so called "contagion effect", which essentially leads to the deemed establishment of any financial institution which would normally be established outside the EU 11 area, but transacts with or acts as an intermediary (as disclosed or

²²⁸ The issuance principle was added to cope with the increased relocation risk of a smaller FTT territory: Explanatory Memorandum EU 11 FTT, see *supra* note 42, 11.

²²⁹ Art. 3 (1) EU 11 FTT Proposal. FTT will not be chargeable when a EU 11 financial institution acts as an intermediary in a transaction not relating to securities issued in the EU 11 area between two non-EU 11 parties. Conversely, it will be chargeable when a non-EU 11 financial institution acts as an intermediary in a transaction where at least one party is established in the EU 11. (see below: contagion effect): O. HENKOW, "The Commission's Proposal for a Common System of Financial Transaction Tax: A Legal Appraisal", *EC Tax Review* 2012, 13.

²³⁰ Art. 4 (4) EU 11 FTT Proposal.

²³¹ Art. 4 (1) (a) and (b) EU 11 FTT Proposal; EC, "Impact Assessment EU 11 FTT", see *supra* note 43, 39. Between participating member states, the various EU "passport" systems will lead to tax liability arising towards the Member State of the financial institution's headquarters. Pursuant to Art. 4 (1) (b), financial institutions with headquarters in a non-participating Member State, but benefitting from a EU "passport" will be liable to the participating member state in relation to whose territory they were authorized for the relevant transactions abroad.

²³² Art. 4 (1) (c), (d) and (e) EU 11 FTT Proposal: for financial institutions respectively registered seat, permanent address (or usual residence) and branch.

²³³ Art. 4 (1) (g) EU 11 FTT Proposal.

undisclosed agent) of a financial or non-financial counterparty which is established within this area.²³⁴ Therefore, the EU 11 FTT includes a fourth type of connecting factor: the counterparty principle. An example might illustrate the extraterritorial implications of this principle: a US investment bank entering into an interest rate swap with the US branch of a German non-financial enterprise will be deemed to be established within Germany for EU 11 FTT purposes and Germany will levy FTT accordingly.

94. A financial institution deemed to be established within a participating Member State might still escape taxation if it "*proves that there is no link between the economic substance of the transaction and the territory of any participating Member State.*"²³⁵ This provision appears to introduce a "substance over form" element to the territorial scope of the EU 11 FTT. HENKOW, however, argues that similar criteria in other fields such as VAT and financial accounting only provide limited guidance and cannot be easily applied to the EU 11 FTT concept.²³⁶ The effect of this provision, as interpreted by the courts, would have important implications for avoidance possibilities.

2.1.3.3 Conclusion

95. Traditional STTs, but also French and Italian FTT, generally choose pragmatic connecting factors that facilitate efficient tax collection. For securities, this will generally be the issuance principle. For more broader FTTs, the use of a local intermediary or residence principle may be useful connecting factors, even though these allow for avoidance through trading migration. True steering FTTs impose greater problems. The consensus is that the superior option is a globally coordinated and enforceable FTT. This being politically unfeasible, the EU 11 FTT has opted for an inclusive cascade of connecting factors, imposing the tax on a great deal of transactions beyond national borders. Notwithstanding the political and legal repercussions of such an approach, it, theoretically, limits incentives (although not all) for relocation and trading migration. Whether theory will coincide with practice depends on the tax collection and enforcement system, which is discussed further below.

2.2 Tax base

96. The notion "tax base" is often used to refer to the instruments which are in scope of a tax. In the interest of conceptual clarity, tax base in this section means the amount on which the final payable tax will be calculated, *i.e.* it is the amount on which the tax rate will be applied.

²³⁴ Establishment of non-financial counterparties is dealt with in Art. 4 (2) EU 11 FTT Proposal and is based on the residence (registered seat, permanent address or usual residence) and issuance principles.

²³⁵ Art. 4 (3) EU 11 FTT Proposal.

²³⁶ See e.g. CJEU C-53/09 and C-55/09, *HMRC v Loyalty Management and Baxi Group*, E.C.R. 2010, I, 9187 (economic substance in the field of VAT); O. HENKOW, "The Commission's Proposal for a Common System of Financial Transaction Tax: A Legal Appraisal", *EC Tax Review* 2012, 14.

2.2.1 Which amount?

97. Given that FTTs are gross transaction taxes, transfers of securities could be taxed on the amount of the actual consideration. Consideration received will generally reflect the current market value of the security, which makes it a viable tax base in the light of FTT objectives. The broker's commission fee may be disregarded (e.g. Belgium).²³⁷ FTTs may employ an at arm's length standard, *viz.* when consideration is lower than market value of the securities, the latter will be taken into account. Examples are Irish stamp duty and South African STT.²³⁸ EU 11 FTT is also calculated on the market price where it is higher than actual consideration or in case of intra-group transactions.²³⁹ In other countries, no at arm's length standard is in place (e.g. Belgium and UK).²⁴⁰ Jurisdictions may also wish to cater for transactions in which consideration does not consist of money (e.g. other securities). UK SDRT, for instance, is assessed on market value in such cases.²⁴¹ When a purchase price is not contained in the contract, French FTT refers to the market price in the most liquid market and, when the shares are unequal in value, both parties are taxed on the market price of the shares of which they take ownership.²⁴²

98. The tax base for spot currency transactions could simply be the amount of the domestic or foreign (if the CTT taxes spot exchanges of foreign currencies) currency that is exchanged.²⁴³ In the latter case, conversion will be necessary.

99. In relation to derivatives, several possible taxable bases contend. Any jurisdiction willing to tax derivatives will have to deal with these intricate issues. With regard to options, three tax bases are possible.²⁴⁴ A first possible tax base is the notional value, *i.e.* the accumulated spot price (market value at the time of conclusion) of the underlying assets. For example, a call option relating to 100 shares with spot price EUR 10 has a notional value of EUR 1000. A second option is that FTTs tax the strike price upon exercise (or even the actual net amount rendered in case of cash-settled options). This may also "incidentally" be the case with physically delivered options when the delivery attracts FTT (e.g. Italy and UK).²⁴⁵ A third possibility, is to tax the premium, *i.e.* the fee rendered by the party holding

²³⁷ Art. 123 WDRT. The purchaser's tax liability is calculated on the purchasing price without the broker's commission. The seller's is calculated on the price, without deduction of the broker's commission.

²³⁸ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 604; Sections 4 (1) (a) (ii) and (b) (ii), 5 (a) (ii) and (b) (ii), and 6 (1) (a) Securities Transfer Tax Act (ZA).

²³⁹ Art. 6 (2) EU 11 FTT Proposal.

²⁴⁰ This may be less relevant, since these FTTs seem to be primarily aimed at non-financial persons.

²⁴¹ 1986 c.41 s.87 (7) (UK).

²⁴² Art. 235 ter ZD (III) CGI.

²⁴³ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 40.

²⁴⁴ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 9, 51; T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 29.

²⁴⁵ See above note 137.

the right to sell (put) or buy (call) the underlying asset.²⁴⁶ Examples of FTTs that tax option premium are Italian FTT and Taiwanese futures transaction tax.²⁴⁷ Indian STT taxes both premium and, in case the option is exercised, strike price.²⁴⁸

100. Futures and forwards may be taxed on either the notional value, *i.e.* aggregated spot price, or their delivery price.²⁴⁹ FTTs may tax the future's delivery price (or even net amount when cash-settled), possibly incidental in case of physically delivered futures/forwards (e.g. UK). Japanese STT was and Italian FTT and Taiwanese futures transaction tax are applied to futures on their notional value.²⁵⁰ Indian STT is assessed on the delivery price.²⁵¹

101. Swaps generally lead to a flow of mutual payments (*i.e.* exchange of cash flows) which are calculated based on a certain reference value (notional value). Three parameters could be used as tax base: (i) each of the gross mutual payments, (ii) the final netted-out payment, and (iii) the notional value.²⁵² Examples of swaps are interest rate swaps ("IRSs") and credit default swaps ("CDSs"). Interest rate swaps often encompass a series of fixed interest rate payments by one party and floating interest rate payments by the other. These are subsequently netted, which leads to a single amount to be settled.²⁵³ The notional value will thus generally be many times higher than the actual payment flows. Credit default swaps, on the other hand, lead to regular payments to the protection seller and, upon materialization of the credit event, a payment based on the value of the underlying (the notional value) to the protection buyer.²⁵⁴ Taxing net or gross payments necessitates tax calculation and collection at settlement.²⁵⁵ The net payment might also not reflect the true value of the contract.²⁵⁶ Furthermore, as is clear from the example above, there is a difference between swaps where it is

²⁴⁶ See R. POLLIN, D. BAKER and M. SCHABERG, "Securities Transaction Taxes for US financial markets", University of Massachusetts Amherst PERI Working Paper, 2001, 26-27, http://scholarworks.umass.edu/cgi/viewcontent.cgi?article=1013&context=peri_workingpapers (hereafter: R. POLLIN *et al.*, "Securities Transaction Taxes") who argue that the premium incorporates the market's valuation of the option and that taxing the premium will lead to the fewer distortions.

²⁴⁷ For the purposes of derivatives with an optional component, Italian FTT equates "notional value" with the premium: see V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 54; D. BEITLER, "Review of Financial Transaction Taxes", see *supra* note 26, 6.

²⁴⁸ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 29. See Section 124 Finance Act 2008 (IN) amending Section 98 and 99 Finance Act 2004 (IN).

²⁴⁹ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 9, 52.

²⁵⁰ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 9, 52; V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 54; D. BEITLER, "Review of Financial Transaction Taxes", see *supra* note 26, 6.

²⁵¹ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 29.

²⁵² The (possibility) of an exchange of payments on regular future dates is a fundamental feature of swaps: see A.M. CHISHOLM, *Derivatives Demystified: A Step-by-Step Guide to Forwards, Futures, Swaps and Options, Second Edition*, Chichester, John Wiley & Sons, 2010, 2 (hereafter: A.M. CHISHOLM, *Derivatives Demystified*).

²⁵³ A.M. CHISHOLM, *Derivatives Demystified*, see *supra*, 59 *et seq.*

²⁵⁴ A.M. CHISHOLM, *Derivatives Demystified*, see *supra*, 69 *et seq.*

²⁵⁵ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 12-13.

²⁵⁶ Therefore, BRONDOLO argues for the taxation of gross payments: J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 27.

certain that mutual payments will be rendered (e.g. IRSs) and those where payments on only one leg of the swap agreement are certain (e.g. CDSs). Tax treatment of CDSs would thus be different depending on whether the credit event occurs, thereby not necessarily coping with inherent risks.²⁵⁷ Generally, the few FTTs that are imposed on swaps tax notional value (e.g. Italian FTT on equity linked swaps and French FTT on sovereign credit derivatives).²⁵⁸ The adoption of a purely mathematical measurement such as notional value, instead of actual payment flows, grants some margin for avoidance. When notional value is given a narrow sense, parties could avoid FTT by simply dividing the notional value by an arbitrary amount and, subsequently, multiplying payments by the same factor.²⁵⁹ Italian FTT specifically caters for this situation and takes into account "*the actual notional value*" (i.e. the reference notional value multiplied by this "leverage effect").²⁶⁰ Next, uncertainty could also arise when swaps employ multiple notional values. EU 11 FTT states that in these circumstances, the highest notional value should be taken into account.²⁶¹

102. In light of the above, it seems that notional value is the only parameter common to all derivatives. EU 11 FTT, in an attempt to take one innovation-proof approach to all derivatives, takes the notional amount, referenced in the contract at the time of conclusion, as tax base.²⁶² Italian FTT does the same, except for options, and is assessed on notional value, corrected for the extent to which the derivative references chargeable securities.²⁶³ Taxing notional value, however, might induce severe market reactions, since it may be several times larger than the contract's value.²⁶⁴ As seen above, there is a case for higher taxation of risky and leveraged derivatives which contribute to systemic risk.²⁶⁵ Notional value is not necessarily a perfect measure for leverage, but it is the best one available. The disadvantage of this approach is that hedging derivatives, unless they somehow benefit from an exemption, will also be taxed on their notional value.

²⁵⁷ The occurrence of the credit event may further lead to double taxation when the protection seller takes physical delivery of the underlying.

²⁵⁸ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 54; Art. 235 ter ZD ter (IV) CGI (FR).

²⁵⁹ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 29. See, for instance, the definition given by the EU 11 FTT: "[...] *the underlying nominal or face amount that is used to calculate payments made on a given derivative contract*", which, in a textual interpretation, would lead to this result (Art. 2 (1) (12) EU 11 FTT Proposal). The GAAR in Art. 13 EU 11 FTT Proposal, however, could probably be employed to ignore any artificial modification of the notional value.

²⁶⁰ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 54.

²⁶¹ Art. 7 EU 11 FTT Proposal. This could, for instance, be the case with IRSs.

²⁶² Art. 7 EU 11 FTT Proposal.

²⁶³ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 54-55.

²⁶⁴ See P.B. SPAHN, "Transactions Taxes, see *supra* note 12, 22. E.g.: the benefit from IRSs used by governments to swap long-term debt for short-term interest payments may be too small to justify their use in the light of an FTT on notional value: EC, "Impact Assessment EU FTT", see *supra* note 5, 53. BRONDOLO argues that taxing the notional value of swaps could lead to an arbitrary tax liability, since it does not necessarily reflect the actual payments exchanged between parties. Instead, he proposes a differential tax treatment for different derivatives: J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 27.

²⁶⁵ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 21-22.

Table IV - Tax base selected FTTs on derivatives

	Options	Futures	Swaps
EU 11 FTT	NV	NV	NV
France (tax on CDSs) ²⁶⁶	-	-	NV
India (STT)	premium upon exercise: strike price	delivery price	-
Italy	premium	NV	NV
Taiwan	premium	NV	-

NV: notional value

2.2.2 Netted amount at settlement

103. As noted above, French and Italian FTT only tax transfers of net positions, *i.e.* actual physical transfers of securities and/or cash. For French FTT, only net purchasing positions will be chargeable, but intermediaries should calculate net buying positions for own account and for account of clients independently.²⁶⁷ Italian FTT becomes due on inter-day net amounts for each liable person and contains an intricate set of rules pertaining to calculation.²⁶⁸ The total tax to be paid could thus be disproportionate to transaction volume if multiple mirrored transactions are concluded. Disparities in practical outcome, however, might be mitigated by the fact that these jurisdictions institute specific regimes for HFT. Nevertheless, sources indicate that the virtual exemption for intra-day trading grants significant leeway for HFT in France.²⁶⁹ Not taking into account gross transactions is very strange for any FTT with a stabilization objective, since it undermines the alleged effect on short-term speculative behaviour.

2.3 Tax rate

2.3.1 General

104. Of all design features, the tax rate is probably the most important. The economic case for FTTs rests on the assumption that it is a low-rate tax on a broad range of transactions. Firstly, the rate

²⁶⁶ Art. 235 ter ZD ter (IV).

²⁶⁷ Which is logical, since ownership is transferred upon entry into the account of the actual purchaser. See PwC, "French FTT", see *supra* note 130, 10.

²⁶⁸ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 52.

²⁶⁹ N. BISSERBE, "French Experiment Shows Trouble with Tax on HFTs", *Wall Street Journal Blog*, 17 October 2013, <http://blogs.wsj.com/moneybeat/2013/10/17/french-experiment-shows-trouble-with-tax-on-hfts/>.

should not be too low or else it would fail at sufficiently discouraging harmful behaviour and raising satisfactory revenue. Secondly, it should not be set too high to prevent distortions and keep the benefits of tax avoidance from outweighing the costs of avoidance schemes.²⁷⁰

105. The tax rate may be structured as an ad valorem rate, *i.e.* as a certain percentage to be applied on the tax base, or a flat fee. Most FTTs apply an ad valorem tax rate. Flat fees may be applicable per transactions as such (e.g. Romanian levy on exchange-traded derivatives) or per unit transferred (e.g. New York State*).²⁷¹ A hybrid approach is possible, *i.e.* the fee increases gradually depending on the tax base with a set maximum (e.g. Italian FTT on derivatives).²⁷² Flat fee FTTs, in contrast to ad valorem rate FTTs, place a higher burden on smaller transactions and therefore encourage order aggregation. This could affect automated trading in very small packets.²⁷³ However, flat fees arguably also affect individual small investors more strongly than financial institutions trading large volumes.

106. FTTs could operate varying rates in order to equalize the ultimate effect of the tax on different financial transactions or accomplish certain policy goals.²⁷⁴ In the first place, tax rates might be different according to the financial instrument. FTTs could impose a different tax rate on, on the one hand, securities and derivatives and, on the other, equity and debt. If jurisdictions wish to maintain pre-tax trading patterns, they could take into account the fact that additional transaction costs (the FTT) will have a stronger proportional effect on financial transactions currently involving lower trading costs.²⁷⁵ Derivatives usually entail very low transaction costs. Therefore, some propose to set the tax rate on the basis of this pre-tax situation.²⁷⁶ Moreover, FTTs will often compensate for the fact that notional value is used as tax base. Accordingly, some FTTs tax derivatives at lower rates (e.g. EU 11 FTT, France, India and Italy).²⁷⁷ It would also seem that tax rates in equity instruments are often higher than on those in debt instruments (e.g. Belgium and Sweden*).²⁷⁸ Secondly, FTTs may provide for lower rates on on-exchange than OTC transactions (e.g. Italy).²⁷⁹ This way, FTTs play a supporting

²⁷⁰ See S. GRIFFITH-JONES and A. PERSAUD, "Financial Transaction Tax", see *supra* note 56, 12 who give an analysis of elasticities of demand for securities in the event of an increase in transaction costs.

²⁷¹ RO (0,10 RON/contract) and NY (0,05 USD per share): EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 3, 670; T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 34.

²⁷² V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 55.

²⁷³ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 34 (if "order shredding" is aimed at making markets more efficient, this could be detrimental).

²⁷⁴ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 7, 16-17.

²⁷⁵ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 34.

²⁷⁶ R. POLLIN *et al.*, "Securities Transaction Taxes", see *supra* note, 20 *et seq.*

²⁷⁷ Art. 9 EU 11 FTT Proposal; Art. 235 ter ZD ter (IV) CGI (FR); National Stock Exchange of India, "Securities Transaction Tax", www.nseindia.com/products/content/derivatives/equities/sec_tranc_tax.htm; V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 55.

²⁷⁸ Art. 121 WDRT (BE); B. CORTEZ and T. VOGEL, "Financial Transaction Tax", see *supra* note 43, 25. Tax rates on equity transactions are higher than those on debt. This is consistent with the difference in fees on these instruments in clearing houses: S. GRIFFITH-JONES and A. PERSAUD, "Financial Transaction Tax", see *supra* note 56, 12.

²⁷⁹ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 51 and 55.

role in encouraging centralization to the detriment of the opaque and risky decentralized markets.²⁸⁰ After one year, the Italian FTT has led to significant migration towards trading venues, together with an overall drop in trading volume.²⁸¹ Other distinctions in tax rate are possible. An example is lower rates for fixed-income instruments with shorter maturities (e.g. money market instruments) to equalize tax effects (e.g. Swedish STT* on debt).²⁸² Brazilian IOF, on the other hand, employs varying tax rates depending on the use of the currency obtained through the FX transaction.²⁸³

107. Certain FTTs put in place a limit on the tax amount per transaction (e.g. Belgium).²⁸⁴ These FTTs are therefore not neutral to transaction size and treat large transactions more favourable, much alike FTTs operating a flat fee per transaction. While this approach may limit certain adverse impacts affecting GDP, it may also result in the tax being borne predominantly by smaller investors.²⁸⁵ Conversely, transactions may be exempted from FTT if consideration does not reach a certain threshold amount (e.g. Cyprus).²⁸⁶ Such a tax could be quite easy to avoid by splitting up transactions.

Table V - Tax rates of selected FTTs (most recent)

	Equity	Debt	Derivatives	Taxes both transaction parties
Belgium	0,25% (max. 740 EUR)	0,09% (max. 650 EUR)	-	Y
EU 11 FTT	min. 0,1%	min. 0,1%	min. 0,01%	Y
France	0,2%	-	CDSs: 0.01% (of NV)	N
Italy	0,1% (on-exchange) 0,2% (OTC)	-	0,01875-200 EUR reduced by 80% if exchange-traded	equity: N derivatives: Y
Sweden*	1984: 0,5% 1986: 1%	Max. 0,15% of principal,	2% on options (price)	Y

²⁸⁰ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 34.

²⁸¹ A. PUAAR, "Italian stock trading falls 30% after FTT", *Financial New*, 23 April 2014, www.efinancialnews.com/story/2014-04-23/italian-stock-trading-dives-by-30-percent-since-trading-tax.

²⁸² B. CORTEZ and T. VOGEL, "Financial Transaction Tax", see *supra* note 43, 25.

²⁸³ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 12-13.

²⁸⁴ Art. 124 WDRT (BE): depending on the transaction EUR 650, 740 or 1500 in 2014.

²⁸⁵ Cf. F. SMETS, "Evaluatie van de belasting op financiële transacties: Economische en budgettaire impact voor België", Belgian Federal Public Service Finance, October 2012, 10, www.docufin.fgov.be/intersalgnl/thema/publicaties/documenta/2012/BdocB_2012_Q3n_Smets_studie.pdf (hereafter: F. SMETS, "Belasting op financiële transacties").

²⁸⁶ Neocleous, "Changes to stamp duty with effect from 1 March 2013", 8 January 2013, www.neocleous.com/index.php?pageid=49&pageaction=neo&modid=102&newid=1662.

		depending on term		
UK	0,5%	-	-	N

Sources²⁸⁷

2.3.2 High speculation-aimed rate

108. A further design option is to levy a prohibitively high tax rate in times of speculative trading. Although such a measure is theoretically possible for a greater number of financial transactions, it has been promoted and debated in relation to CTTs. Indeed, often other methods are available to bring speculation to a halt for other instruments.²⁸⁸ SPAHN first introduced this concept as an amendment of TOBIN's CTT to enhance its capacity of coping with speculative attacks and making it a worthy substitute for costly central bank intervention.²⁸⁹ It essentially involves a two-tier tax rate structure: (i) a basic low-rate FTT on spot and derivative FX transactions, and (ii) a high "exchange surcharge" to the extent the exchange rate surpasses a fixed band around a set target rate. It therefore leads to a *de facto* FX market suspension when price fluctuations suggest large speculative profits. Belgium has introduced a (non-operative) Spahn-type CTT with a general tax rate of 0.02 % and a high rate which may not exceed 80% when the exchange rate surpasses band margins around a target rate adjusted every 20 days.²⁹⁰

2.4 Conclusion: tax base and rate

109. Tax rate and base are subtle instruments in limiting distortions and exerting policy choices, yet with great potential. An astute combination of both could create disincentives for risky instruments or equalize effects between different markets and product types. Conversely, the way in which the tax base is calculated could also severely limit the tax's effectiveness (e.g. tax on net positions). Traditional STTs, but also Italian FTT, make use of this potential. Other than targeting notional value of derivatives, the EU 11 FTT does not. Moreover, the participating Member States can only adopt different tax rates for derivatives on the one hand and the other transactions in scope on the other. No

²⁸⁷ **BE:** Art. 121 and 124 WDRT. **EU 11 FTT:** Art. 9 EU 11 FTT Proposal. **FR:** Art. 235 ter ZD (V) and 235 ter ZD ter (IV) CGI. **IT:** V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 51 and 55. **SE:** B. CORTEZ and T. VOGEL, "Financial Transaction Tax", see *supra* note 43, 25. **UK:** HMRC, "Stamp Duty Reserve Tax - the basics", www.hmrc.gov.uk/sdrt/intro/basics.htm.

²⁸⁸ Trading in stock markets may be suspended, central banks may (threaten to) buy up government debt to support the price, etc.

²⁸⁹ P.B. SPAHN, "Transactions Taxes", see *supra* note 12, 31 *et seq.* For an analysis of Spahn's proposal see L. VAN LIERDE and D. CASSIMON, "Een werkbare belasting op internationale kapitaaltransacties", *AFT* 2000, 248-251.

²⁹⁰ Art. 8 Law on foreign exchange taxation. The Law states that the Belgian ministerial council will determine the high tax rate.

other divergences between products or markets are allowed.²⁹¹ Adopting varying tax rates and/or bases requires meticulous market analysis and entails high enforcement costs in a constantly evolving market and may be detrimental to harmonization in a EU setting where Member States still decide on the final tax rate.

2.5 Tax collection and enforcement

110. An efficient and low-cost tax collection and enforcement system is of the highest importance to meet the objectives.²⁹² Flaws could facilitate widespread evasion and, consequently, bring about lower revenues, higher distortions and, when leveraged products are left untaxed in practice, higher systemic risk. EU 11 FTT has not fully worked out its full collection and enforcement mechanism. The Proposal contains mandates to the Commission and participating Member States are granted some leeway in transposition.²⁹³

2.5.1 Importance of financial market infrastructure and regulation

111. Secondary financial markets have an intricate structure which encompasses a web of market participants with different business models and objectives. Some trade for their own account (*i.e.* they invest, speculate, hedge, etc.), others aim to make a profit by facilitating transactions and another group engages in both activities. To understand how the activity of these persons and the regulatory requirements imposed on them may be leveraged for FTT collection and enforcement, a brief overview of the operational steps surrounding financial transactions is necessary.²⁹⁴

112. The first step in the transaction process is the matching of offer and demand. Parties may enter into the transaction bilaterally, *i.e.* over-the-counter ("OTC"). For example, a bank could enter into a swap agreement with a hedge fund without the involvement of any third party and without the use of a trading platform. Offer and demand could also be matched through an organized trading venue. Trading venues exist in different forms subject to varying amounts of regulation. Furthermore, transactions might be concluded using the services of intermediaries. Dealers, brokers and market

²⁹¹ Article 9 (3) EU 11 FTT Proposal.

²⁹² M. TISON, "Opinion note: The introduction of a FTT - some considerations from a legal perspective" in Leading Group, "How can we implement today a Multilateral and Multi-jurisdictional Tax on Financial Transactions - Technical notes: Draft version", October 2011, 16, <https://biblio.ugent.be/input/download?func=downloadFile&recordOId=2004278&fileOId=2004395> (hereafter: M. TISON, "FTT - considerations from a legal perspective").

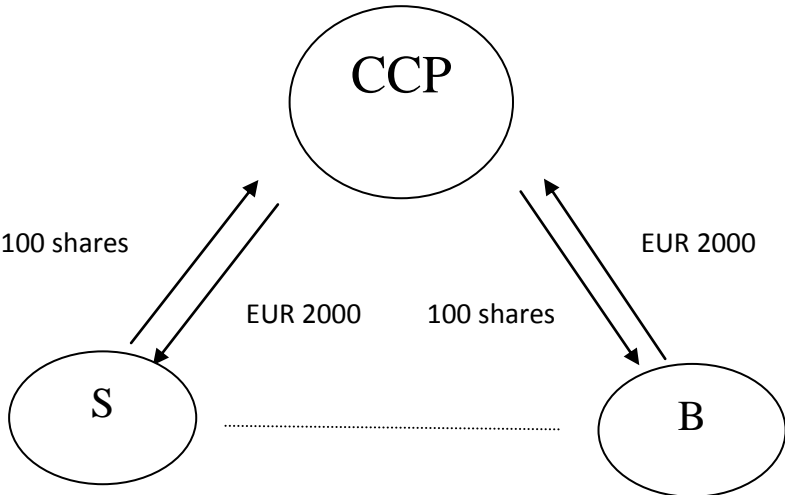
²⁹³ See below note 330.

²⁹⁴ For an overview of the transactional steps in the CDS market see S. CERULUS, "Central Clearing for Credit Default Swaps - Efforts in the EU and the US to combat systemic risk through regulation", Master's thesis University of Louvain 2011, 15-18, <http://ssrn.com/abstract=2173211> (hereafter: S. CERULUS, "Central Clearing").

makers may intervene and match parties with contrary intentions, legally acting either as agents or principals. The bank from the example above might, for instance, run a matched book by entering into a converse IRS with another client or a broker may, directly or through other intermediaries, execute a client's order to buy shares on a stock exchange. One economic transaction may involve several intermediaries.

113. Once the transaction is concluded, it will be cleared and settled. Clearing envelops the period from conclusion until settlement during which the net position of each party is determined. This period may be very short (security transactions) or extend throughout the duration of the contract (derivatives).²⁹⁵ Settlement is the final legal performance of the transaction, *i.e.* the delivery of securities and/or payment. Clearing and settlement might occur completely bilateral between the transaction parties²⁹⁶ or be centralized through the intervention of central counterparties (CCPs), clearinghouses and securities settlement systems (SSS). Below is an example of the possible operation of a CPP in relation to a simple share transfer between two clearing members (**Figure II**). Seller S and buyer B have concluded a contract for the sale of 100 shares against EUR 2000 on day T. On T+1 or T+2 the transaction is reported to the CCP²⁹⁷, which interposes itself and becomes counterparty (creditor and debtor) of both parties and thus guarantees performance. On day T+3 the transaction is settled.²⁹⁸ The CCP ensures that delivery of 100 shares by S and payment of EUR 2000 by B occur simultaneously, *i.e.* "delivery versus payment" ("DVP"), and performs its own obligations by ensuring delivery of the shares to B and the money to S.

Figure II - Operation of CCPs: example



²⁹⁵ S. CERULUS, "Central Clearing", see *supra* note 294, 10.
²⁹⁶ Transaction parties may then mitigate counterparty risk by requiring collateral and providing for close-out netting: see S. CERULUS, "Central Clearing", see *supra* note 294, 38-42.
²⁹⁷ For another example see J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 8.
²⁹⁸ Some CCPs may also settle on trade day or even in real-time (e.g. CREST): Euroclear, "Streamlined real-time settlement - Euroclear UK & Ireland's CREST system", 2, www.euroclear.com/dam/PDFs/Settlement/EUI/MA2740-CREST-settlement.pdf.

When securities are held in securities accounts, the entity operating the SSS (a central securities depository or CSD)²⁹⁹ will take care of delivery by debiting the account of the selling clearing member and crediting the account of the buying clearing member. These members might in turn hold securities for their clients. The money-leg of the transaction is often settled on settlement accounts held with settlement banks connected to CCPs.³⁰⁰ A clearinghouse may furthermore provide clearance services by netting out the positions of its clearing members, e.g. if B is entitled to EUR 500 under another transaction, the CPP has a net claim of EUR 1500. Clearance and settlement services may be provided by one and the same or by several entities.³⁰¹ Certain entities providing such services may also not be CCPs in the strict sense, since they do not take on the existing obligations of parties.³⁰² Access to these systems is possible for clearing members. Other market participants (e.g. intermediaries) may access CCPs through these clearing members.

114. In a third stage, specific transaction reporting and post-trade transparency obligations may be imposed on the parties or other actors (see no. 130).

115. As is apparent from the overview above, different steps in this process can be centralized (*i.e.* multilateral) or decentralized (*i.e.* bilateral). Some markets have a high level of centralization in all stages (e.g. listed shares) as opposed to traditionally highly decentralized markets (e.g. OTC credit default swaps). Other markets show centralized as well as decentralized elements (e.g. bonds and centrally cleared OTC derivatives).³⁰³ Centralization may be used to leverage tax administration. This is because it usually implies the intervention of a single entity, a financial market infrastructure ("FMI"), which can be used as a focus point for several elements in tax collection, assessment and enforcement.³⁰⁴ Moreover, existing and pending regulation relating to these entities or aimed at higher centralization for certain products might convey useful instruments for administering FTTs at low cost.

²⁹⁹ CSDs are those entities who record securities in a book-entry system or maintain securities accounts at the top tier level and operate securities settlement systems ("SSSs"): see Art. 2 (1) (1) and Section A Annex of the Proposal for a Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC, COM(2012) 73 final.

³⁰⁰ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 8.

³⁰¹ E.g.: trades on Euronext Brussels are cleared by LCH.Clearnet SA and settlement is provided by the ESES system encompassing multiple Euroclear CSDs. See BIS, "Payment, clearing and settlement systems in the CPSS countries - Volume 2", November 2012, 120 *et seq.*, www.bis.org/publ/cpss105.pdf (hereafter: BIS, "Payment, clearing and settlement systems").

³⁰² E.g.: the CREST settlement system (see below) does not act as a central counterparty towards seller and buyer: J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 47.

³⁰³ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 19-21.

³⁰⁴ For the notion FMI see BIS, "Principles for financial market infrastructures", April 2012, 7 *et seq.*, www.bis.org/publ/cpss101a.pdf.

2.5.2 Person liable to pay

2.5.2.1 FMIs and intermediaries as collecting agents

116. Centralization could be leveraged for the purposes of tax collection. In addition to the transaction parties, centralized clearing and settlement mechanisms and financial intermediaries involved in the chargeable transaction could incur liability towards the tax authorities. Entities providing for settlement would then become liable to the tax authorities for the taxable transactions processed by their systems. The CCP could withhold or collect the tax from the transaction parties.³⁰⁵ Similarly, financial intermediaries could be held to withhold or collect tax from their clients when they interfere in the transaction. Jurisdictions may also use a cascade system, in which one person becomes liable or tax authorities may enforce, when the person primarily held to collect fails to do so or no such person is available. For example, when a jurisdiction opts to collect FTT through CCPs, a fallback scenario is necessary for those situations in which chargeable instruments are not centrally settled or instruments are settled through foreign settlement systems on which tax enforcement is not possible. The same is possible when transactions, which are in principle centrally settled, are not because the transfer is executed within the books of an intermediary on a lower level. This occurs when, for instance, buyer and seller have their investment accounts with the same broker who is registered as the holder of the securities on a higher level (e.g. the securities are on the broker's account with the CSD). The broker can then settle the transaction internally, transferring securities and payment between the buyer's and seller's accounts.³⁰⁶

117. Tax collection by settlement systems and, to a lesser extent, financial intermediaries provide several benefits. This approach substantially reduces the amount of persons liable to pay FTT, which leads to lower enforcement costs. Furthermore, it allows the use of economies of scale, which will lower total compliance costs.³⁰⁷ The same effect is partly possible under FTTs only aimed at financial institutions. Taxes that are withheld by a third party generally have a higher compliance rate than self-assessed and reported ones.

³⁰⁵ If the CCP operates on a deferred net basis and one clearing member has a net selling position (*i.e.* has a claim for payment on the CCP), the CCP should have the right to withhold the tax. If the clearing member has a net buying position, the CCP has a claim encompassing both the net and tax amount and could make use of the usual instruments it has at its disposal for collection (e.g. collateral, margins, etc) and, potentially, the joint and several liability of the counterparty.

³⁰⁶ For this problem see HMRC, "Stamp Taxes Manual", see *supra* note 17, 247: when a nominee holds the legal title and the beneficial interest is transferred to a person who is using the same nominee.

³⁰⁷ T. MATHESON, "Taxing Financial Transactions", see *supra* note 20, 7; J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 14.

118. The availability of CCPs and intermediaries depends on the market involved. Transactions in listed shares are generally processed by CCPs, even when traded OTC.³⁰⁸ Debt securities such as bonds are often traded OTC, but centrally settled. Exchange-traded derivatives, such as futures, also have a long history of central clearing and settlement. Other markets are notoriously decentralized: e.g. the market for OTC swaps.³⁰⁹ Recent regulatory developments, however, are rapidly changing the transactional landscape for OTC derivatives. Following proposals formulated within the G-20, the EU is imposing mandatory clearing requirements for certain standardised OTC derivatives involving financial and, in some cases, non-financial counterparties in EMIR.³¹⁰ In the US, similar requirements are included in the Dodd-Frank reform.³¹¹ Some accounts estimate, for instance, that 70% of credit derivatives will be centrally cleared.³¹² In addition, the pending MiFIR Proposal introduces a clearing obligation for derivatives traded on a regulated market.³¹³ Higher capital requirements or collateral requirements for bilaterally cleared and settled derivatives provide even higher incentives for centralization.³¹⁴ These reforms could be leveraged to ensure efficient tax collection.³¹⁵ Some transactions may be concluded without the involvement of intermediaries. In these cases, however, one of the parties will often be a financial institution already collecting FTT in the framework of its client business. In these instances, the financial institution itself may be liable, possibly also for the FTT due on the counterparty leg of the transaction.

119. Tax collection through CCPs brings about some technical issues. Centralized settlement systems would possibly have to amend their operational infrastructure and invest resources in tax collection. Jurisdictions may therefore provide for some remuneration mechanism to avoid clearance services becoming more expensive: e.g. France allows Euroclear France to keep the interest generated on the collected FTT, which is put in a deposit account before payment to the tax authorities.³¹⁶ One specific issue is the processing of exempted transactions. Parties could be required to evidence the entitlement to an exemption, *i.e.* to avoid FTT being collected or to acquire a tax rebate. Such an approach is only feasible for specific large-value or rare transactions, else it would raise administration costs. Jurisdictions may also rely on claims made by parties but require them to store evidence for possible subsequent tax audits. CREST (see no. 122), for instance, uses a system of "Transaction Tax

³⁰⁸ Insofar as this is possible. See J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 7.

³⁰⁹ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 19-21.

³¹⁰ See Art. 4 EMIR.

³¹¹ See S. CERULUS, "Central Clearing", see *supra* note 294, 78 *et seq.*

³¹² S. GRIFFITH-JONES and A. PERSAUD, "Financial Transaction Tax", see *supra* note 56, 10.

³¹³ See Art. 29 Position of the European Parliament adopted at first reading on 15 April 2014 with a view to the adoption of Regulation (EU) No .../2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No 648/2012, P7_TC1-COD(2011)0296 (hereafter: MiFIR Proposal). This is the most recent text adopted by the European Parliament.

³¹⁴ Cf. S. GRIFFITH-JONES and A. PERSAUD, "Financial Transaction Tax", see *supra* note 56, 10.

³¹⁵ D. SCHÄFER, "Financial Transaction Tax", see *supra* note 45, 83.

³¹⁶ PwC, "French FTT", see *supra* note 130, 12.

Status Flags", which are put into the system at the time of settlement by the parties who obtain and then store the required evidence.³¹⁷

120. A possible issue is that taxable persons may take recourse to foreign CCPs and financial intermediaries to avoid the tax. Tax enforcement on these entities may be difficult, even when FTTs have a broad territorial scope. An example is the Belgian stock exchange tax, which is, as explained above, quite easily avoided by using foreign intermediaries. Even if tax authorities would give a different interpretation to the provisions setting out its territorial scope, enforcement would still be very difficult. In fact, the choice for connecting factors is usually guided by pragmatic considerations in relation to tax enforcement. This type of avoidance may be limited by the nature of certain instruments. For securities held by CSDs, for instance, registration of the transfer by debiting and crediting the relevant accounts could be necessary for the transfer of ownership, which is in turn necessary to exercise claims and rights connected to the instrument (e.g. voting rights, right to distributions, etc.).³¹⁸ UK SDRT, for instance, makes use of this practical necessity through its use of the CREST system (see no. 122).

2.5.2.2 *Joint and several liability of other parties*

121. A further design option is to impose joint and several liability on other parties somehow involved to allow tax authorities to recuperate the full amount when the person who was initially liable to pay fails to do so. Transaction parties could, for instance, be held liable for the tax debt of their counterparty. Such an approach provides a useable enforcement instrument to deal with cross-border transactions where one of the parties is located abroad.

2.5.2.3 *Examples*

122. UK SDRT and Irish stamp duty are collected through CREST, which is the securities settlement system for the UK and Ireland.³¹⁹ Tax collection is deemed to be very cost-efficient.³²⁰ For transactions settled outside CREST, the "accountable person" will be held to pay SDRT. A cascade system is used in which several intermediaries and, ultimately, the purchaser himself is liable.³²¹ Other

³¹⁷ HMRC, "Stamp Duty Reserve Tax reliefs and exemptions", www.hmrc.gov.uk/sdrt/reliefs/reliefs-exemptions.htm.

³¹⁸ E.g.: Art. 468 Companies Code (BE) provides that the book-entry of securities leads to a right of co-ownership on the body of securities held by the institution with whom the account is held. Ultimately, a CSD is positioned at the top tier and entered into the shareholder register.

³¹⁹ The CREST system is operated by Euroclear UK & Ireland (the CSD for the UK and Ireland) and settles a wide range of corporate and government securities. See BIS, "Payment, clearing and settlement systems", see *supra* note 301, 465 *et seq.*

³²⁰ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 10.

³²¹ HMRC, "Stamp Taxes Manual", see *supra* note 17, 253.

examples of jurisdictions that collect or have collected FTT through the settlement systems connected to stock exchanges are Greece* and Romania.³²²

123. An important amount of countries require financial intermediaries to collect FTT. In Belgium, professional intermediaries are held to pay stock exchange tax on all transactions concluded on own account or for the account of clients. The transactions parties who are not professional intermediaries can never be required to pay the tax.³²³ Other FTTs taking the approach of collecting through financial intermediaries are Swiss STT and the US stamp duty*.³²⁴ US Section 31 fees are collected by brokers in practice. Legally, however, it are the self-regulatory organizations and securities exchanges who are liable to pay the tax based on total transaction volume. These require their broker-dealer members to pay a share of the fees.³²⁵ The latter in turn charge fees to their customers. This is a good example of how a (admittedly very marginal) FTT on financial institutions may be pushed down to retail investors and companies.

124. Italy makes certain financial intermediaries liable to pay the tax when involved in the execution of chargeable transactions.³²⁶ When multiple intermediaries are involved, it is the one who receives the execution order that is held to pay, unless the final counterparty is itself a financial intermediary. In the latter case this party is held to pay the tax. Italy allows these liable intermediaries to give a power of attorney to CCPs to collect the tax. France makes investment service providers ("ISPs") liable to the tax when acting as a purchaser or executing trades for the account of the purchaser. ISPs are generally brokers.³²⁷ The purchaser as such will only be liable if he is an ISP. When no intermediary interferes, the custodian holding the securities is liable. French FTT requires the CSD (*i.e.* Euroclear France) to collect FTT from these liable persons on a periodical basis as an agent.³²⁸ Accordingly, the French and Italian FTTs use several levels of market infrastructure, allowing or requiring collection through CCPs.

125. EU 11 FTT has as a starting point that all financial institutions involved in the transaction chain incur a separate tax liability, unless when acting for the account of another financial institution. All parties to a chargeable transaction, whatever their nature (financial or non-financial entities and natural persons), are jointly and severally liable to pay the tax of other parties involved when it is not

³²² EC, "Impact Assessment EU FTT", see *supra* note 5, 585 and 669-670.

³²³ Art. 126/2 WDRT (BE).

³²⁴ EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 8, 9; L.H. SUMMERS and V.P. SUMMERS, "When Financial Markets Work Too Well: A Cautious Case For a Securities Transactions Tax", *Journal of Financial Services Research* 1989, 284.

³²⁵ SEC, "Section 31 Transaction Fees", www.sec.gov/answers/sec31.htm.

³²⁶ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 60-62.

³²⁷ Art. 235 ter ZD (VI) CGI (FR); PwC, "French FTT", see *supra* note 130, 11-12.

³²⁸ Art. 235 ter ZD (VII)-(X) CGI (FR); Société Générale Securities Services, "Financial Transaction Tax", www.securities-services.societegenerale.com/en/regulatory-watch/financial-transaction-tax/.

rendered by the due date. This is a measure particularly useful in light of the counterparty principle, as even non-financial counterparties of a foreign financial institution will be liable to the latter's tax debt. Participating Member States may even designate other persons who will incur liability.³²⁹ The Commission receives a mandate to adopt uniform collection procedures. Such a measure might be possible in light of several provisions throughout the Proposal.³³⁰ Commission officials, however, have indicated that, in light of subsidiarity, such a uniform collection measure will only be adopted if requested by the participating Member States.³³¹

2.5.2.4 *Special case: foreign exchange*

126. The foreign exchange market, encompassing both spot and derivative transactions, has traditionally been very decentralized and stretches out on a global scale. It exists of an interbank market where trading is conducted between dealers, possibly with intermediation by brokers, and a customer market where dealers trade with their customers (financial and non-financial firms).³³² The past decennia, however, elements of centralized settlement have been introduced to cope with settlement risk and to economize on the benefits of centralization.³³³ SCHMIDT was the first to point out the opportunities for FTT administration.³³⁴ Currency transactions may be settled through the normal systems of transferring bank deposits, in which either party transfers bank deposits denominated in the currency they are selling to the other party, possibly using the intermediation of correspondent banks and/or payment systems.³³⁵ The latter are either retail or large value payment systems ("LVPS"), usually operated by central banks, which may settle credit transfers made by its members on the basis of, respectively, deferred net settlement ("DNS") or real-time gross settlement ("RTGS").³³⁶ Although tax collection through RTGS payment systems might be possible, there are some hurdles. Firstly, given that spot FX transactions involve two domestic currencies, the transaction

³²⁹ All of these rules are contained in Art. 10 EU 11 FTT Proposal.

³³⁰ Art. 11 (5) EU 11 FTT Proposal: the Commission may adopt implementing acts providing for uniform methods of collection. The participating member states may, in general, provide that other persons than those referred to above will be jointly and severally liable for payment (Art. 10 (4)) and shall lay down obligations (the addressees are not specified) to ensure that FTT is effectively paid (Art. 11 (1)). With regard to this latter task, the Commission is entitled to adopt delegated acts specifying the measures to be taken (Art. 11 (2)).

³³¹ See the remarks made by Heinz ZOUREK, Director General of DG TAXUD before the EU Economic and Financial Affairs Sub-committee of the House of Lords: House of Lords, "Financial Transaction Tax: Alive and deadly - Evidence", December 2013, 6-7, www.parliament.uk/documents/lords-committees/eu-sub-com-a/FTTAliveanddeadly/FTTAliveanddeadlyEVFINAL.pdf (hereafter: House of Lords, "Financial Transaction Tax - Evidence").

³³² J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 33.

³³³ See Investopedia, "Settlement risk", www.investopedia.com/terms/s/settlementrisk.asp.

³³⁴ R. SCHMIDT, "Foreign Exchange Transactions Tax", see *supra* note 12, 3.

³³⁵ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 35.

³³⁶ The terminology used here is the one employed by the ECB. See e.g. ECB, "Oversight Standards for Euro Retail Payment Systems", June 2003, 8 p., www.ecb.europa.eu/pub/pdf/other/retailpsoversightstandardsen.pdf?e22ebf915a54ea5da02420ece2ddd173. DNS systems usually net all gross payments processed once each day and settle the net positions. RTGS systems provide continuous settlement of gross payments. Smaller market participants can access the system through the members.

might be settled through two systems located in different jurisdictions, which implies that settlement is not truly centralized and brings about problems of territoriality. Secondly, it is not clear whether all LVPSs are technically capable of distinguishing payments in the framework of FX transactions from other payments.³³⁷ Thirdly, payments in payment systems may already constitute the netted-out amount resulting from external netting operations.³³⁸ Finally and perhaps most importantly, many countries still have retail payment systems for low value transactions, which operate on a deferred net basis and not RTGS.³³⁹ However, the CLS Bank, which was founded in 2002 and operates as centralized settlement system for spot and other FX transactions, may offer a solution.³⁴⁰ This system functions on the basis of payment versus payment ("PVP") and is connected to national LVPSs. As such, tax collection through the CLS Bank might be possible analogous to collection through CCPs. Moreover, the CLS Bank is estimated to settle the majority of total foreign exchange transactions. A substantial issue, however, is that a local FTT may encounter difficulties in enforcing tax collection on the CLS Bank, which is incorporated in the US, primarily supervised by the US Federal Reserve and settles payments in 17 different currencies, for which the central banks connected to these currencies conduct oversight.³⁴¹ The rather symbolic Belgian CTT requires the financial intermediary transacting on own account or for the account of a client to pay the tax as sole liable party. When no financial intermediary is involved, however, the transaction parties are liable. When one of the transaction parties is established abroad, the domestic party is jointly and severally liable.³⁴² Brazilian IOF is also collected by financial institutions authorized to trade in the FX markets.³⁴³

2.5.3 Reporting, tax assessment and information rights

127. A further question is, on the one hand, how the person liable to pay will record and report chargeable transactions and, on the other, what powers tax authorities have to ascertain whether all chargeable transactions have been reported and to assess the FTT. It should be distinguished from the concept of tax collection as discussed above, e.g. tax authorities in a system that does not require CCPs to collect FTT might still have some information rights against them.

³³⁷ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 37. KAPOOR *et al.* argue that the SWIFT messaging system may be used to identify FX transactions, *viz.* the absence of a matching message in the same currency to the message encompassing a transfer of money indicates a FX transaction: see S. KAPOOR, D. HILLMAN and S. SPRATT, "Taking the next step - Implementing a Currency Transaction Development Levy", Stamp Out Poverty, February 2007, 19-21, http://mpr.ub.uni-muenchen.de/4054/1/MPR_paper_4054.pdf.

³³⁸ R. SCHMIDT, "Foreign Exchange Transactions Tax", see *supra* note 12, 15.

³³⁹ E.g.: the Belgian retail payment system CEC. For large-value payments, the European Target 2 RTGS system is used. The Target 2 platform is also used for the settlement of the CEC end-of-day positions. BIS, "Payment, clearing and settlement systems", see *supra* note 301, 16 *et seq.*

³⁴⁰ CLS stands for continuous linked settlement. See J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 36.

³⁴¹ *Cf.* J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 36 and 48. See BIS, "Payment, clearing and settlement systems", see *supra* note 301, 103.

³⁴² Art. 10 Law on foreign exchange taxation.

³⁴³ J.D. BRONDOLO, "Taxing Financial Transactions", see *supra* note 22, 38.

128. Using non-financial individual transaction parties as a focus point for tax assessment and compliance checks generally runs into the same problems as discussed above in the light of tax collection: it raises compliance and enforcement costs. Other, more suitable, focus points for tax assessment and information gathering exist.

129. Record-keeping and reporting obligations may be imposed on financial institutions, as transaction parties or as intermediaries involved in a taxable transaction. EU 11 FTT, for instance, requires financial institutions to keep relevant data at the disposal of tax authorities for at least five years and all persons liable to pay FTT to submit monthly tax returns.³⁴⁴ Compliance costs may very well be limited, since extensive record-keeping obligations are already in place for financial institutions, who could employ existing infrastructure. Specifically for EU 11 FTT, the use of similar terms and cross-references to MiFID limits the need for material alterations to existing systems.³⁴⁵ In addition to the obligation to submit tax returns, tax authorities could be granted direct investigatory rights towards these institutions. Belgian stock exchange tax requires tax returns and grants tax authorities such rights towards financial intermediaries.³⁴⁶ HMRC has the power to conduct compliance checks on, for example, securities dealers and look into SDRT records.³⁴⁷ Information rights towards and recording obligations for clearing and settlement entities are also possible.³⁴⁸ This might be in the framework of tax collection (e.g. UK stamp duty), but also as a general enforcement tool to identify transactions on which FTT was not paid. The French authorities, for instance, have direct control rights on the CSD responsible for tax collection.³⁴⁹ Similar rights could also be granted towards trading venues. The MiFIR Proposal already imposes enhanced data maintenance obligations on trading venues.³⁵⁰ Furthermore, the Proposal provides for mandatory trading of standardized derivatives on trading platforms, which, again increases the availability of centralized information for tax enforcement.³⁵¹

130. Further similar obligations in financial market legislation may be relevant. In this regard, the Commission has indicated that, for the purpose of enforcement, participating Member States "*should*

³⁴⁴ Art. 11 (3) and (4) EU 11 FTT Proposal.

³⁴⁵ Art. 11 (4) EU 11 FTT Proposal refers to Art. 25 (2) MiFID, which requires investment firms to keep relevant data relating to transactions in financial instruments for own account or on behalf of clients for at least five years. The information is of a high quality and detail: the records contain, *inter alia*, information concerning the identity of clients. Other legislation may be leveraged too. Art. 9 EMIR imposes record-keeping obligations on derivatives counterparties for five years.

³⁴⁶ Art. 125 (§1) and 130/2 WDRT (BE).

³⁴⁷ See HMRC, "HMRC compliance checks into Stamp Duty Reserve Tax transactions", www.hmrc.gov.uk/sdrt/penalties/enquiries.htm.

³⁴⁸ CCPs already have record-keeping obligations under Art. 29 EMIR.

³⁴⁹ Art. 235 ter ZD (X) CGI (FR).

³⁵⁰ Art. 25 (2) MiFIR Proposal.

³⁵¹ Art. 28 MiFIR Proposal.

take advantage of existing and forthcoming EU legislation on financial markets that includes reporting and data maintenance obligations with respect to financial transactions."³⁵² More specifically, transaction reporting under MiFID and recent rules on the reporting of derivative transactions under EMIR come to mind. The current transaction reporting regime under MiFID requires investment firms (or certain entities acting on their behalf) which execute trades in relation to financial instruments admitted to trading on a regulated market to report such transactions to their home state regulator and the regulator of the most important market for those instruments in terms of liquidity. This mechanism generates detailed information.³⁵³ Furthermore, the coming MiFID reform is expected to broaden the scope on several fronts. Data maintenance and transaction reporting requirements will be contained in MiFIR and will probably extend to transactions in all financial instruments traded on a trading venue and their derivatives and will impose reporting obligations on trading venues for transactions executed by non-investment firms (*i.e.* those not subject to the general reporting obligation).³⁵⁴ Importantly for FTT enforcement, reports would contain information identifying the client, which will remain intact even when investment firms are merely transmitting (*i.e.* not executing) orders.³⁵⁵ Accordingly, MiFIR would provide some opportunities for FTT enforcement. EMIR requires transaction reporting to so-called trade repositories and this for *all* derivatives (*i.e.* not limited to OTC derivatives).³⁵⁶ The information to be transmitted is highly detailed.³⁵⁷ However, at this point, tax authorities do not have direct access to trade repositories.³⁵⁸

2.5.4 Frequency of and term for payment

131. Payment could be made either per chargeable transaction or periodically, for all tax charges that have arisen during a given period of time. Payment per chargeable transaction is inherent to all traditional stamp duties. Historically, payment was made when the document was presented to the stamp office (e.g. UK stamp duty) or stamps were bought in advance and attached to the transaction document (e.g. old Belgian stamp duty).³⁵⁹ These systems do grant a certain term for payment. Under current circumstances, such an approach requires a highly developed electronic infrastructure if compliance costs are to be held low. Therefore, where CCPs or even financial institutions collect the

³⁵² Explanatory Memorandum EU 11 FTT, see *supra* note 42, 13.

³⁵³ See Art. 23 (3) to (6) MiFID. Reports contain details on the instruments concerned, quantity, date and time, prices and the investment firms concerned.

³⁵⁴ Art. 26 (1), (2) and (5) MiFIR Proposal.

³⁵⁵ Art. 26 (3) and (4) MiFIR Proposal. When firms transmit orders, they will include the necessary details or immediately report to the regulator.

³⁵⁶ Art. 9 EMIR. Reporting is also necessary for modifications of the contract.

³⁵⁷ Art. 9 (5) (a) and (b) EMIR. Reports include specification of the parties and information on *inter alia* notional value, price and settlement date.

³⁵⁸ Tax authorities are not included in the list of Art. 81 (3) EMIR. The Commission seems to consider, however, that tax authorities would be able to request information from other authorities under the exchange mechanism in Art. 84 EMIR: see Recital (58) EMIR.

³⁵⁹ J.J. COUTURIER, B. PEETERS and N. PLETS, *Belgisch belastingrecht (in hoofdlijnen)*, Maklu, Antwerp, 2012, 1103.

tax, it might be feasible to demand that payment of FTT is made per transaction. UK SDRT takes this approach and requires payment after 14 calendar days.³⁶⁰ The notion is taken a step further by EU 11 FTT, which provides that FTT is to be paid *immediately* at the moment of chargeability when transactions are carried out electronically. When this is not the case, payment must be made within three working days.³⁶¹

132. FTTs adhering to the system of periodical payments usually align the period for which payment must be made and that for which tax returns are submitted. Belgium, for instance, requires intermediaries to pay all stock exchange tax charges for a specific month by the last working day of the following month, accompanied by a tax return.³⁶² A similar approach is taken by Italy.³⁶³ France requires Euroclear France, who collects the tax from ISPs to render the collected amounts each month.³⁶⁴ UK SDRT takes a similar approach when the tax is not collected through CREST.³⁶⁵ Periodical collection is more favourable to the collecting agent or transaction party paying the FTT, as it may be allowed to put the funds temporarily to use (e.g. generate interest), thereby setting off some of the compliance costs (e.g. see no. 119).

2.5.5 Penalties and/or interest

133. Imposing penalties and/or a, possibly penalizing, interest rate on FTT payments not made within the prescribed term or in case of misreporting or non-reporting are important instruments in combating tax evasion. Higher penalizing costs in case of discovery lead to a theoretical increase in the cost of and a consequent decrease in evasion. Therefore, higher penalties or interest rates may be useful in combating evasion in relation to transactions with a high evasion risk (e.g. cross-border transactions). At the same time, however, they may exceed what is deemed to be fair and lack a clear link to legal notions such as culpability and proportionality. The above would explain why some FTTs with a lower risk of evasion (e.g. UK SDRT) impose lower sanctions than those with a high evasion risk (e.g. Belgium).³⁶⁶

³⁶⁰ HMRC, "How to pay Stamp Duty Reserve Tax", www.hmrc.gov.uk/payinghmrc/stamp-reserve.htm (hereafter: HMRC, "How to pay SDRT").

³⁶¹ Art. 11 (5) EU 11 FTT Proposal.

³⁶² Art. 125 (§1) WDRT (BE).

³⁶³ V. SALVADORI DI WIESENHOFF and R. EGORI, "Italian FTT", see *supra* note 66, 61.

³⁶⁴ Art. 235 ter ZD (VII) CGI (FR).

³⁶⁵ HMRC, "How to pay SDRT", see *supra* note 360.

³⁶⁶ E.g. the penalty for misreporting is the lower of five times the tax amount and EUR 250 for Belgian stock exchange tax and a penalty not greater than the tax amount for UK SDRT: Art. 125 (§2) WDRT (BE); HMRC, "Penalties and appeals - Stamp Duty Reserve Tax", www.hmrc.gov.uk/sdrt/penalties/penalties-appeals.htm.

2.5.6 Special penalty: legal standing

134. UK stamp duty historically has a special feature in design, made possible by its connection to physical transaction documents. UK Stamp Act 1891 c.39 s.14 (4), which applies to both stamp duty and SDRT, provides that unstamped documents cannot be relied upon or used for any purposes other than production in a criminal case. Since stamp duty is applicable to documents that evidence transfer of ownership and SDRT on agreements of transfer of ownership, this provision severely limits the legal enforceability of a transaction. Accordingly, the transfer of shares will not be registered by the company registrar.³⁶⁷ This means that, as far as shares are concerned, buyers will not be able to rely on their shareholder rights. This rule therefore goes further than non-enforceability in court of law. It amounts to a prohibition for certain third parties to recognize the transaction as having legal effect. Another jurisdiction requiring tax payment for legal enforceability is Malta.³⁶⁸

135. Similarly, jurisdictions could provide that transactions on which the tax has not been paid are ineligible for clearing and settlement. No problem exists when the settlement system as such is required to collect the tax. In any other case, a mechanism is necessary to ascertain whether FTT has been paid on a certain transaction. The liberalizing electronic tag proposed by the Leading Group and referred to above may qualify.³⁶⁹ No CSD or CCP would then be allowed (or willing for that matter) to clear and settle the transaction. Transactions on which FTT has been paid could, for instance, be entered into a registry and existing identifying codes could be employed.³⁷⁰ In some situations impossibility of settlement would imply that rights connected to the instrument are not available (e.g. securities held by a CSD). In case of derivatives, ineligibility for clearing could bring about issues under EMIR and higher capital requirements. However, the use of foreign CCPs or recourse to foreign courts is conceivable in this situation. Derivatives contracts on which FTT has not been paid could still be legally enforceable in this foreign jurisdiction, especially since derivatives contracts are very often governed by the laws of jurisdictions currently opposed to the introduction of FTTs. Foreign CPPs or other financial institutions may, however, refuse such business, unless the clearing member or counterparty has sufficient assets within their jurisdiction or posts high amounts of collateral, since any judicial ruling might not be enforceable in its home state. This and comparable courses of action leave considerable uncertainty and market participants may prefer to pay the low-rate FTT,

³⁶⁷ HMRC, "Stamp Taxes Manual", see *supra* note 17, 10.

³⁶⁸ KPMG, "Overview of taxes on financial transactions within the EU - Malta", www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/financial-transaction-tax-survey/Pages/Malta.aspx.

³⁶⁹ Leading Group, "Tax on Financial Transactions", see *supra* note 28, 24.

³⁷⁰ See Explanatory Memorandum EU 11 FTT, see *supra* note 42, 13. E.g.: the ISO Classification of Financial Instruments (CFI/ISO 10962).

particularly when they are bound by certain fiduciary duties or regulatory requirements (e.g. pension funds, insurance companies, banks, etc.).³⁷¹

2.5.7 Anti-avoidance provisions

136. Several specific measures in FTT design discussed above limit avoidance or evasion opportunities.³⁷² FTT legislation could also include a general anti-abuse rule (GAAR), which is drafted in a general and abstract way with the purpose of capturing legal arrangements that do not attract FTT, but have an economic substance similar or equal to transactions that do. This provision could then be employed as an *ultimum remedium* against avoidance by tax authorities when transactions cannot be brought within scope, but allow parties to achieve the same economic result without bearing the charge. EU 11 FTT introduces such a GAAR, which employs multiple concepts each bearing meaning accumulated over time (*inter alia* artificiality, economic substance and essential purpose to avoid tax) and may therefore be difficult to apply.³⁷³ The proposal mandates participating Member States to take further measures to prevent tax evasion and fraud.³⁷⁴ Another example of a FTT introducing a GAAR is South African STT.³⁷⁵ An overly broad GAAR may be very instrumental in limiting tax avoidance, but will also introduce significant uncertainty and raise compliance costs.

2.5.8 Tax enforcement on transactions abroad and mutual assistance

137. FTTs introduce elements of extraterritoriality to prevent tax avoidance, but extending the territorial scope to transactions abroad is only one step in effectively countervailing avoidance. Charging these transactions should also be enforceable. The question is how this can be achieved in a system based on respect for national sovereignty, *i.e.* where jurisdictions cannot enforce their (tax) laws outside their borders. Several aspects of this issue have already been touched upon above (e.g. no. 120).

138. Some transactions concluded abroad may pose little issues in specific instances (e.g. securities in a national CSD). This might be different in other situations (e.g. derivatives). The taxing jurisdiction may be able to request the foreign jurisdiction for help by providing information or even enforcing the tax charge on its account pursuant to a treaty.³⁷⁶ In the EU, the mutual assistance regime

³⁷¹ Cf. S. GRIFFITH-JONES and A. PERSAUD, "Financial Transaction Tax", see *supra* note 56, 10.

³⁷² E.g.: enlarging the territorial scope, taxation of (close) substitutes, adoption of the at arm's length standard in the assessment of tax base, the inclusion of depository receipts under the issuance principle, etc.

³⁷³ Art. 13 EU 11 FTT Proposal; J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 226.

³⁷⁴ Art. 12 EU 11 FTT Proposal.

³⁷⁵ Section 9 Securities Transfer Tax Act 2007 (ZA).

³⁷⁶ E.g.: the OECD-Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

and, more particularly, the Tax Recovery Directive and Mutual Assistance Directive concerning respectively mutual assistance in tax recovery and exchange of information are relevant.³⁷⁷ Both apply to FTTs in principle.³⁷⁸ The UK House of Lords has expressed its opinion that HMRC will be bound to exchange information and assist in tax collection if the EU 11 FTT were to be adopted.³⁷⁹ In any case, grounds for a foreign tax authority to refuse assistance under both Directives are very limited and seemingly irrelevant in this context.³⁸⁰ Therefore, Member States would be able to request certain information from other Member States, who shall carry out the necessary administrative enquiries.³⁸¹ Member States may also request other Member States to assist in the recovery of tax claims. The requested state will do this using its own tax collection procedures and legislation.³⁸² The results of previous EU mutual assistance instruments in the field of taxation have been underwhelming.³⁸³ It remains to be seen whether the aforementioned Directives, which have been strengthened, will offer a sufficient tool for FTT enforcement abroad.

139. In any case, mutual assistance mechanisms are usually aimed at situations where tax liability is litigious and tax authorities have exhausted other methods. Therefore, they may not be particularly suited as a first resort in day-to-day tax collection. Moreover, mutual assistance agreements with third countries may fall short. Commission officials have expressed their belief that this might not be a problem, since there is a business in FTT collection for foreign market entities.³⁸⁴ While there may be some truth in this assertion, there could then also be a business in *not* collecting the tax, *i.e.* facilitating avoidance, which would be quite easy when using derivatives.

2.5.9 Conclusion

140. Whether jurisdictions want to reduce harmful behaviour or raise revenue, cost-efficient and effective tax collection is equally important. Jurisdictions generally use either centralized settlement

³⁷⁷ Directive Council, No 2010/24/EU, 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, *OJ. L.* 31 March 2010, 84, 1 (hereafter: Tax Recovery Directive); Directive Council, No 2011/16/EU, 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/99/EEC, *OJ. L.* 11 March 2011, 64, 1 (hereafter: Mutual Assistance Directive).

³⁷⁸ The Directives are applicable to all taxes unless an exception exists: Art. 2 Tax Collection Directive and Art. 2 Mutual Assistance Directive; P. KAVELAARS, "Bank Taxes in Forms and Sizes: EC Opts for FTT", *Intertax* 2012, 412. See also Explanatory Memorandum EU 11 FTT, see *supra* note 42, 14.

³⁷⁹ House of Lords, "Financial Transaction Tax: Alive and deadly", December 2013, 9, www.publications.parliament.uk/pa/ld201314/ldselect/ldecom/86/86.pdf.

³⁸⁰ See *inter alia* Art. 17 Mutual Assistance Directive and Art. 18 Tax Recovery Directive.

³⁸¹ Art. 1 (1), 5 and 6 Mutual Assistance Directive and Art. 5 Tax Collection Directive.

³⁸² Art. 10 (1) and 13 (1) Tax Collection Directive.

³⁸³ See EC, "Report from the Commission to the Council and the European Parliament on the use of the provisions on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures in 2005-2008", COM(2009), 6, http://ec.europa.eu/taxation_customs/resources/documents/common/whats_new/com%282009%29451_en.pdf.

³⁸⁴ See House of Lords, "Financial Transaction Tax - Evidence", see *supra* note 331, 7 and 12 on the distinction between "regular" tax collection and administrative cooperation and making a business out of tax collection.

systems or financial intermediaries as a primary focus point for tax collection. Mixed or fallback systems are also possible. Other elements of modern market infrastructure, which is becoming increasingly centralized, and recent regulatory developments facilitate tax enforcement to a large extent due to the existence and accessibility of detailed transaction data. Within domestic markets, FTT collection and enforcement should not raise any insurmountable issues. However, gathering information or tax recovery abroad could be much more problematic. This is exactly the weak point of any national or regional FTT. Problems may be less severe for securities settled by CSDs and traded on national trading venues or when (assets of) one party involved can be located within the taxing state's territory and tax authorities have investigatory rights towards this party.

IV ALTERNATIVES FOR THE INTRODUCTION OF A FINANCIAL TRANSACTION TAX

141. Several alternatives for FTTs exist. The alternatives may pursue one or more objectives, mainly financial sector taxation and reduction of systemic risk. Two possible alternatives are discussed briefly: the bank levy, or "financial stability contribution", and financial activities tax (FAT). Both were proposed by the IMF in 2010, following a request from the G-20 to identify possible options to demand a fair contribution from the financial sector.³⁸⁵

1 Bank levy

142. Bank levies come in different forms and sizes. They are often aimed at raising revenue to cover past or future government support during crises, but the exact objective and design is country-specific.³⁸⁶ Bank levies might be used to finance a specific fund (e.g. Germany) or the general government budget (e.g. France and UK). In addition to their obvious revenue potential, bank levies could also reduce the risk of future crises. Firstly, financial institutions internalize the cost of crises and revenue is sometimes used to finance the winding-up of failed institutions and may therefore complement resolution mechanisms being put in place.³⁸⁷ Secondly, bank levies could be based on leverage-indicators, *i.e.* debt. Accordingly, bank levies are often calculated based on the (adjusted) liability-side of the balance sheet.³⁸⁸ As a result, the debt bias inherent to corporate income taxation

³⁸⁵ IMF, "A fair and Substantial Contribution By The Financial Sector", June 2010, 5, www.imf.org/external/np/g20/pdf/062710b.pdf (hereafter: IMF, "Fair Contribution").

³⁸⁶ B. LARKING, "Existing National Taxation", see *supra* note 43, 48.

³⁸⁷ B. LARKING, "Existing National Taxation", see *supra* note 43, 39.

³⁸⁸ The Belgian annual tax on credit institutions (introduced in 2012) is quite atypical in that it is based on a part of certain savings deposits, *viz.* those which are exempt for the purposes of income tax imposed on the depositor (Art. 201/11 WDRT).

could be counterbalanced.³⁸⁹ They may, however, also be computed on the book-value of certain risky assets (e.g. France) or have specific provisions covering derivative positions.³⁹⁰ Several countries have adopted bank levies since the financial crisis (*inter alia* Austria, Belgium, France, Germany, Netherlands, UK, US and Sweden) and these show some clear differences in design.³⁹¹

2 FAT

143. Financial services and insurances are exempted in many VAT systems.³⁹² This partly stems from the difficulties encountered in applying VAT to products for which profits are derived from margins (e.g. the difference between interest received on outstanding loans and interest paid to depositors).³⁹³ The exemption leads to several distortions.³⁹⁴ Financial institutions cannot deduct VAT paid on their own purchases, which is therefore (partially) incorporated in services extended to customers. Business customers, who would normally be able to recover the charge, now are not. This leads to cascading effects through the system.

144. A FAT, as a source-based value added tax, might compensate for the perceived under-taxation.³⁹⁵ Three types of FAT are distinguished by the IMF. FAT 1 is seen as a substitute for VAT. It applies to the value added by a financial institution, *i.e.* all wages and economic profits.³⁹⁶ Since tax recovery by business customers would still not be possible, it is suggested that the tax rate of such a FAT should be substantially below the VAT rate.³⁹⁷ Some countries already had FAT 1 type taxes before the financial crisis. Examples are Israel, Quebec, France and Denmark.³⁹⁸ The latter two are additional wage taxes to sectors exempt under VAT. FAT 2 is more narrow in that it applies to "supernormal" wages and profits. FAT 3 is even more limited and would only apply to very high

³⁸⁹ T. MATHESON, "Financial Sector Taxation and the Ongoing Financial Crisis" in O. MARRES and D. WEBER, *Taxing the Financial Sector*, Amsterdam, IBFD, 2012, 205 (hereafter: T. MATHESON, "Financial Sector Taxation").

³⁹⁰ T. MATHESON, "Financial Sector Taxation", see *supra* note 389, 207.

³⁹¹ See KPMG, "Bank Levies - comparison of certain jurisdictions", June 2012, 16 p., www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/bank-levy-9v2.pdf.

³⁹² For the EU see Art. 135 Directive Council No. 2006/112/EC, 28 November 2006 on the common system of value added tax, *OJ. L.* 11 December 2006, 347, 1. (hereafter: VAT Directive). H. GRUBERT and R. KREVER, "VAT and Financial Services: Competing Perspectives on What Should Be Taxed", *Tax Law Review* 2012, 203.

³⁹³ R. VAN DER PAARDT, "FTT and VAT" in O. MARRES and D. WEBER, *Taxing the Financial Sector*, Amsterdam, IBFD, 2012, 152 (hereafter: R. VAN DER PAARDT, "FTT and VAT").

³⁹⁴ Cf. C. FUEST, "The Financial Activities Tax (FAT) as a way forward?", Presentation at the Brussels Tax Forum, 28-29 March 2011, 10, http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/conferences/taxforum2011/fuest_pt.pdf.

³⁹⁵ B2C services may be under-taxed, whereas this is arguably not the case for B2B: R. VAN DER PAARDT, "FTT and VAT", see *supra* note 393, 156.

³⁹⁶ P. KAVELAARS, "Bank Taxes in Forms and Sizes: EC Opts for FTT", *Intertax* 2012, 404.

³⁹⁷ T. MATHESON, "Financial Sector Taxation", see *supra* note 389, 209.

³⁹⁸ E.g.: the French tax on wages (*taxe sur les salaires*) applies to wages paid by employers who are exempt from VAT (Art. 231-231 bis U CGI). T. MATHESON, "Financial Sector Taxation", see *supra* note 389, 209.

remuneration and profits. The economic rationale varies for each of the distinct types. FAT 1 is devised as a substitute for VAT in the financial sector. FAT 2 is a tax on economic rents procured as a result of the sector's particular role in the economy.³⁹⁹ FAT 3, finally, clearly has a steering function and aims to reduce typical incentives for excessive risk-taking.

3 The "right" tax

145. It would seem that broad-based FTTs theoretically have the greatest revenue-raising capacity. However, since the risk of migration is higher, it is possible that revenue erodes over time. In this case, FAT 1 would be a close second, followed from a distance by FAT 2 and 3.⁴⁰⁰ It is often argued that FTTs have a greater distortive effect and impact on GDP and that the risk of end-users bearing the final tax burden is higher.⁴⁰¹ Broadening the territorial or objective scope of FTTs might safeguard revenue raising to a certain extent, but could also strengthen these distortive effects. Bank levies and FATs, especially FAT 3, could succeed in reducing, respectively, the overall amount of leverage in the financial sector and incentives for excessive risk-taking generated by "too big to fail" effects, both phenomena deemed material in the emergence of the recent crisis. FTTs could be employed in reducing the systemic risk connected to excessive leverage in a more lateral fashion, e.g. by taxing derivatives on their notional value and providing additional incentives for centralized clearing and settlement in the form of lower tax rates. This effect is, however, more secondary to the primary aim, *i.e.* reducing the chance of bubbles induced by short-term speculation, which is an activity not necessarily addressed by bank levies or FATs.⁴⁰² Although noise trading is not often considered to be one of the causes of the recent financial crisis, this does not mean that it could not have such an effect in the future. The appreciation of FTT effectiveness is therefore still dependent on the economic view on the effects of speculation. There is a danger that a combination of the different tax types, in addition to the numerous regulatory initiatives, leads to an "overkill". Moreover, many argue that the introduction of a FTT on a local level may prove less feasible. On the basis of these considerations and together with some economists, the IMF and, initially, the European Commission have expressed their preference for alternatives to FTTs.⁴⁰³

³⁹⁹ The idea is that financial institutions are able to secure above-normal profits for the same amount of input as compared to operators in other economic sectors. The tax should therefore theoretically apply to the amounts that exceed a normal profit in the next most profitable sector. See T. MATHESON, "Financial Sector Taxation", see *supra* note 389, 210.

⁴⁰⁰ See EC, "Impact Assessment EU FTT", see *supra* note 5, 32-34.

⁴⁰¹ E.g.: J. ANTHONY *et al.*, "FTT: review and assessment", *supra* footnote 79, 20.

⁴⁰² Excessive rents taxed under FAT type taxes could, however, encompass profits from speculative trading.

⁴⁰³ EC, "Taxation of the financial sector", COM(2010) 549 final, 8; IMF, "Fair Contribution", see *supra* note 385, 19 *et seq.*

SECOND PART - THE LEGALITY OF A TAX ON FINANCIAL TRANSACTIONS IN THE EUROPEAN UNION

146. The issue of the legality of FTTs has developed into the central battleground in the fierce debate surrounding the EU 11 FTT. This second part sets out to assess FTT conformity with areas of law which are often referred to as problematic. Although the analysis starts from the notion of FTTs in general and remains relevant if the proposal were to be put aside, specific attention is given to some notorious features of the EU 11 FTT.

I CUSTOMARY INTERNATIONAL LAW: TAX JURISDICTION

1 The legal relevance of customary international law in the European institutional order

147. Article 38 of the Statute of the International Court of Justice, which lists the sources of international law, mentions "*international custom, as evidence of a general practice accepted as law*".⁴⁰⁴ Therefore, customary international law forms an integral part of public international law. The question, however, remains whether and to what extent EU institutions are bound by such law when adopting legislation. Art 3 (5) TEU provides that the EU shall contribute to "[...] *the strict observance and the development of international law*." The Grand Chamber of the CJEU has confirmed that EU institutions are bound by international customary law when adopting legislative acts and that these acts are void if in breach of said law.⁴⁰⁵ A material qualification to this rule, however, is that the CJEU will limit its review to a "manifest error" test, since international customary law only has a limited degree of precision.⁴⁰⁶ The Union legislator must be manifestly erroneous when assuming competence.

2 International jurisdiction

148. State sovereignty, in principle, extends solely to its territory or its nationals. The milestone PCIJ *Lotus* case loosened this strict approach. Distinction is to be made between a state's jurisdiction to enforce, which is strictly territorial, and its jurisdiction to prescribe, which was, at the time of the judgment, not subject to a "*general prohibition [...] to extend the application of [...] laws and the*

⁴⁰⁴ Art 38 (b) Statute of the International Court of Justice.

⁴⁰⁵ CJEU C-366/10, *Air Transport Association of America et al. v Secretary of State for Energy and Climate Change*, E.C.R. 2011, I, 13755.

⁴⁰⁶ See also J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 236-237.

jurisdictions of [the] courts to persons, property and acts outside [its] territory".⁴⁰⁷ The current consensus, however, is that international jurisdiction is limited by the requirement of a connecting factor or "nexus" between the legislating state and the conduct, person or property involved.⁴⁰⁸ In this context, jurisdiction could be based on the principle of territoriality, *i.e.* on the connection with the state's territory, or on the principle of personality, *i.e.* on the connection with the state's nationals. The principle of territoriality is often extended, *inter alia* in securities and competition law, to allow legislation on persons, property or conduct outside national borders based on (harmful) effects within the national territory (*i.e.* the "effects" test or objective territoriality).⁴⁰⁹

3 The legality of FTT's territorial scope

3.1 Traditional connecting factors

149. The traditional connecting factors employed to determine the territorial scope of FTTs are generally in accordance with these principles.⁴¹⁰ The residence principle leads to taxation of transactions concluded by domestic companies worldwide and transactions concluded by the domestic branches of foreign companies. This is an application of the personality principle. The taxation of domestic branches of foreign persons may be construed as an application of the principle of territoriality.⁴¹¹ The conclusion of a transaction establishes a clear and direct link to the territory in which it occurs. Therefore, the place of transaction principle is probably in accordance with rules on international tax jurisdiction.⁴¹² The adoption of the issuance principle for securities leads to taxation of transactions in securities issued by companies established within the national territory. It would seem that the extraterritorial effect of FTTs based on this principle has been internationally accepted (e.g. France, Italy and the UK).⁴¹³

⁴⁰⁷ PCIJ, *The Case of the S.S. "Lotus"* (France v Turkey), *PCIJ Series A*, n° 10, 1927, 19.

⁴⁰⁸ On the (contemporary) limits of the *Lotus* case see C. RYNGAERT "Jurisdiction in International Law: United States and European Perspectives", Doctoral thesis, 2007, 33-42, <https://lirias.kuleuven.be/bitstream/1979/911/2/doctoraat.pdf> (hereafter: C. RYNGAERT, "Jurisdiction").

⁴⁰⁹ See also J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 238. On the effects test in competition/antitrust law see: C. RYNGAERT, "Jurisdiction", see *supra* note 408, 194 *et seq.*

⁴¹⁰ See also Commission Services, "Response to the opinion of the Legal Service of the Council on the legality of the counterparty-based deemed establishment of financial institutions (Art. 4(1) point f) of the FTT proposal COM(2013) 71 final)", 8, available at <http://www.openeurope.org.uk/Content/Documents/Pdfs/FTTECLegalOpinion.pdf> (hereafter: Commission Services, "Legality of the counterparty-based deemed establishment").

⁴¹¹ J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 240.

⁴¹² Cf. J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 240.

⁴¹³ EC, "Impact Assessment EU 11 FTT", see *supra* note 43, 40.

3.2 EU 11 FTT

150. The Legal Service ("LS") of the Council, in an opinion dated 6 September 2013, considered the counterparty principle to be contrary to customary international law as understood in the EU.⁴¹⁴ As a reminder, this principle leads to the deemed establishment of non-EU 11 financial institutions when they act as a counterparty or intermediary for persons established within the EU 11. The LS enjoys the support of some authors in this opinion.⁴¹⁵

151. The underlying assumption of both the LS and said authors is that, in order to ascertain whether a "genuine" link with the territory or nationals of the taxing state exists, it should be observed whether another state has a "*more relevant interest*" in imposing the FTT on the persons involved.⁴¹⁶ More specifically, this is to be assessed in reference to the objectives of the FTT legislation. The objectives of the EU 11 FTT Proposal, which are to raise revenue, demand a fair contribution from the financial sector and reducing risks in the financial markets, cannot justify the exercise of tax jurisdiction over foreign financial institutions in the LS's opinion. For all of these objectives, the home state of the financial institution has a more relevant interest in imposing the tax. Providing for means to counteract tax evasion, which is in itself a consequence of the tax, cannot be allowed as a justification. In addition, ENGLISCH *et al.* deem the application of the issuance principle to be problematic.⁴¹⁷ The objectives of the EU 11 FTT do not justify recourse to this principle, whereas UK SDRT does, since the latter is allegedly conceived as a tax on the use of the CREST system or even an indirect tax on capital.

152. The Commission's Legal Service, on the other hand, candidly rejects the arguments brought forth by its Council counterpart.⁴¹⁸ In essence, it argues that the requirement to forgo taxation when other states have a more relevant interest is "*not a valid standard under international customary law which [the counterparty principle] would have to comply with*".⁴¹⁹ The only relevant criterion is the connection with the taxing state. Regard is to be had to the actual object of the FTT, *i.e.* a transaction, and not necessarily the individual parties. In this sense, the financial transaction has a sufficiently close nexus with the taxing participating Member State's territory, given that it leads to the

⁴¹⁴ Legal Service of the Council, "Legality of the counterparty-based deemed establishment of financial institutions (Art. 4(1) point f) of the Proposal", 6 September 2013, 6-8, available at <http://daskapital.nl/images/other/RvE-transactietaks-oordeel.pdf> (hereafter: Council Legal Service, "Legality of the counterparty-based deemed establishment").

⁴¹⁵ J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 240-241.

⁴¹⁶ Council Legal Service, "Legality of the counterparty-based deemed establishment", see *supra* note 414, 7; J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 238-239.

⁴¹⁷ J. ENGLISCH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 241-244.

⁴¹⁸ Commission Services, "Legality of the counterparty-based deemed establishment", see *supra* note 410, 3-11.

⁴¹⁹ Commission Services, "Legality of the counterparty-based deemed establishment", see *supra* note 410, 5.

"achievement of a legally relevant result within the State".⁴²⁰ It is the counterparty who voluntarily enters into a transaction with a resident and subjects itself and the transaction to the tax competence of the relevant participating Member State.

153. The issue boils down to the question whether one adheres to the jurisdictional rule of reason or similar doctrines. § 403 (1) of the 1987 Restatement (Third) of Foreign Relations Law of the United States, which is a non-binding, yet authoritative set of rules, excludes jurisdiction to prescribe "*with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable.*"⁴²¹ The Commission's LS refers to this rule to argue that any reference to other State's interests "*only reflects the principle of comity*" and is as such non-binding.⁴²² § 403 (1), however, does reflect the jurisdictional rule of reason which urges restraint when national interests do not outweigh another state's interests.⁴²³ This does not mean that the LS's conclusion is incorrect. For one thing, the Restatement itself provides for some counterarguments.⁴²⁴ Much more important, however, is that, notwithstanding their academic and political merits, the application of the rule of reason and similar concepts, such as the requirement of a genuine connection and the principle of jurisdictional proportionality, are by no means commonly accepted to be part of customary international law.⁴²⁵ The principle of territoriality, however, is. In this respect, a transaction is probably sufficiently connected to a state's territory when one of the parties is established within its territory or when the transaction's object embodies a claim on such a person.⁴²⁶ Moreover, in the author's opinion, it would not be manifestly false to contend that EU 11 FTT objectives are in many cases aligned with taxation of foreign conduct. In the interest of financial stability, it could be important to ensure that transactions concluded between (non-financial) residents and foreign financial institutions are taxed (e.g. OTC derivatives). With relation to taxation of domestically issued instruments, it should be noted that the interests of a particular state go further than ensuring the stability of the domestic financial markets. The objective of financial market stability is not a purpose in itself. Well-functioning financial markets are necessary in efficiently financing the real economy. High price volatility could make it more costly for domestic issuers to attract finance. This reasoning stretches out to foreign trading in domestic securities (e.g. in the form of ADRs).

⁴²⁰ Commission Services, "Legality of the counterparty-based deemed establishment", see *supra* note 410, 9.

⁴²¹ American Law Institute, *Restatement of the Law (Third): Foreign Relations Law of the United States*, American Law Institute Publishers, 1987.

⁴²² Commission Services, "Legality of the counterparty-based deemed establishment", see *supra* note 410, 5.

⁴²³ C. RYNGAERT, "Jurisdiction", see *supra* note 408, 145.

⁴²⁴ § 403 (2) of the Restatement includes a list of factors to be taken into account when assessing whether the exercise of jurisdiction is unreasonable. Legislative objectives are thus not the only factor. In addition, RYNGAERT indicates that the comments to § 403 point towards more leeway for the legislature (*i.e.* Congress) as opposed to *inter alia* the administration: C. RYNGAERT, "Jurisdiction", see *supra* note 408, 150.

⁴²⁵ C. RYNGAERT, "Jurisdiction", see *supra* note 408, 152-153: this issue is heavily debated.

⁴²⁶ With relation to tax jurisdiction, § 412 (4) of the Restatement provides that a "*state may exercise jurisdiction to tax a transaction that occurs, originates, or terminates in its territory or that has a substantial relation to the state, without regard to the nationality, domicile, residence, or presence of the parties to such a transaction.*"

154. Following from these observations, it is very doubtful whether the EU 11 FTT would be held contrary to customary international law in light of the manifest error test. Participating Member States are probably not manifestly erroneous in assuming that they have tax jurisdiction.

II EUROPEAN UNION LAW

1 Treaty Freedoms

155. The question arises whether a FTT, which, by definition, raises transaction costs on financial transactions, infringes upon any of the Treaty freedoms. The analysis below sets out to: ascertain whether the notion of taxing financial transactions as such is contrary to internal market law (1.2) and identify whether any specific design features alter this conclusion (1.3).

1.1 Capital Duty Directive or primary EU law?

156. As will be discussed below, FTTs may come in scope of the Capital Duty Directive. The CJEU has confirmed on multiple occasions that, when a matter is harmonized at EU level, national measures in scope should be assessed in the light of the harmonizing legislative act and not in the light of primary EU law.⁴²⁷ The question whether STTs may only be assessed on the basis of the CDD, since Article 6 (1) (a) explicitly allows duties on the transfer of securities (see no. 194), must be answered in the negative. The first and current CDDs are directed at the harmonization of indirect taxes on the raising of capital.⁴²⁸ Indirect taxes on securities transactions are not harmonized and were originally to be the subject of another harmonizing directive, which was never adopted.⁴²⁹ In other words, the exclusion in the aforementioned Article is certainly not an implicit fiat for all STTs by the Union legislator, but rather an indication that STTs, in general, remain outside of the CDD's scope, unless they encroach upon the activity within scope (e.g. issuance). Therefore, when national FTTs enter the harmonized realm of the CDD (e.g. in case of a charge on original issuance), they should be assessed solely on the basis of the CDD. However, when this is not the case (e.g. taxation of secondary market transactions in securities or taxation of FX transactions or derivatives), the Treaty freedoms remain in full vigour.

⁴²⁷ Primary EU law will, however, be relevant for the interpretation of the harmonizing act. See *inter alia* CJEU C-178/05, *Commission v Greece*, E.C.R. 2007, I, 4185, para 31; CJEU C-569/07, *HSBC Holdings plc and Vidacos Nominees Ltd v HMRC*, E.C.R. 2009, I, 9047, para 26.

⁴²⁸ CJEU C-178/05, *Commission v Greece*, E.C.R. 2007, I, 4185. For the same conclusion: First Tier Tribunal (Tax Chamber) UK 28 February 2012, no. TC/2009/16584, para 320 *et seq.*, www.bailii.org.

⁴²⁹ CJEU C-466/03, *Albert Reiss Beteiligungsgesellschaft v Baden-Württemberg*, E.C.R. 2007, I, 5357, para 10; Amended Proposal for a Council Directive relating to indirect taxes on transactions in securities, COM(87) 139.

1.2 Starting point: the concept of taxing financial transactions

1.2.1 Applicable Treaty freedom

157. Financial transactions with a cross-border element (e.g. the parties are resident in different Member States) may be protected by one or more Treaty freedoms. Therefore, the first step is to determine which freedom is applicable.

158. Article 63 TFEU prohibits all restrictions on the movement of capital and on payments between Member States and between Member States and third countries. The Treaty gives no further definition of capital movements. According to well-established CJEU case law, the non-exhaustive nomenclature contained in Annex I to Directive 88/361 (the final liberalizing Directive in relation to freedom of capital movements) has indicative value.⁴³⁰ Consequently, capital movements include direct investments, with a view of establishing or maintaining lasting economic links, as well as portfolio investments such as, *inter alia*, cross-border acquisitions of securities normally dealt in on the capital or money market and operations in units of collective investment funds.⁴³¹ Transactions subject to STT will, therefore, generally come within scope of the free movement of capital.⁴³²

159. Article 56 TFEU prohibits restrictions on the provision of services between nationals of different Member States. Financial intermediaries provide services relating to chargeable transactions to (financial) businesses and individual investors by, for instance, supporting liquidity as market makers or executing transactions for the account of customers. Following from Article 57 TFEU and CJEU case law, *"the concept of 'services' [...] implies that they are ordinarily provided for remuneration and that the remuneration constitutes consideration for the service in question and is agreed upon between the provider and the recipient of the service."*⁴³³ Despite possible conceptual difficulties in applying this definition to the activity of financial institutions earning profit on margins⁴³⁴, it seems readily intelligible that several activities relating to intermediation and trade

⁴³⁰ See *inter alia*: CJEU C-222/97, *Manfred Trummer and Peter Mayer*, E.C.R. 1999, I, 1661; CJEU C-302/97, *Konle v. Austria*, E.C.R. 1999, I, 3099; CJEU-452/04, *Fidium Finanz v Bundesanstalt für Finanzdienstleistungsaufsicht*, E.C.R. 2006, I, 09521, para 41. In *Verkooijen* the Court confirmed that the capital movements notion extends beyond the categories in the nomenclature: CJEU C-35/98, *Staatssecretaris van Financiën v B.G.M. Verkooijen*, E.C.R. 2000, I, 4071; M. ISENBAERT, *EC Law and the Sovereignty of the Member States in Direct Taxation*, Amsterdam, IBFD Publications BV, 2010, 313.

⁴³¹ I, III, IV and V Annex I Directive Council No. 88/361, 24 June 1988 for the implementation of Art. 67 of the Treaty, OJ. L. 8 July 1988, 178, 5.

⁴³² G. DIETLEIN, "National Approaches towards a Financial Transaction Tax and Their Compatibility with European Law", *EC Tax Review* 2012, 208.

⁴³³ CJEU C-168/08, *Presidente del Consiglio dei Ministri v Regione Sardegna*, E.C.R. 2009, I, 10821, para 23. See also CJEU C-109/92, *S.M. Wirth v Landeshauptstadt Hannover*, E.C.R. 1993, I, 6464 and CJEU C-355/00, *Freskot AE v Elliniko Dimosio*, E.C.R. 2003, I, 5287.

⁴³⁴ E.g.: market makers generate profit from the spread between bid and ask quotes and not necessarily from fees received from customers. A possible argument in favor of their qualification as services can be found in CJEU

execution for which financial institutions receive a fee or commission constitute services in the sense of Article 56 TFEU.⁴³⁵ Certain transactions subject to STT are therefore within scope of the free movement of services.

160. Does this situation warrant cumulative application or will one Treaty freedom prevail? The CJEU has rendered several judgments on this issue. Despite some (even recent) case law, in which the Court applies all of the freedoms involved simultaneously⁴³⁶, an approach of identifying the primary freedom at stake is emerging.⁴³⁷ Accordingly, it is necessary to assess to what extent the exercise of the freedoms is affected and whether the restriction under one freedom is not merely an inevitable consequence of the restriction under the other, in which case the latter prevails.⁴³⁸

161. FTTs, in general, seek to tax certain forms of capital movements, possibly even with the objective of reducing their volume. Being essentially a transaction cost, they affect certain financial transactions. FTTs therefore primarily affect capital movements. The subsequent effect on financial services is an inevitable consequence. Put differently, financial intermediaries may experience a reduction in the provision of, for example, cross-border brokerage services, but this would be a logical consequence of the FTT's effect on the profitability of transactions and not of its effect on the ability to provide services as such. Therefore, the conformity of FTTs with primary EU law should be assessed under the freedom of capital movements.⁴³⁹ The analysis could be more complex, however, for STTs which, in practice, operate as taxes on the use of certain brokerage services. Belgian stock exchange tax, for instance, solely applies when a transaction is concluded through a financial intermediary. Moreover, most transactions on the "wholesale" level are excluded (see no. 71).

162. The free movement of capital is also applicable in the relationship to third countries. This difference with free movement of services is not relevant at this point.

jurisprudence, in which their activity is defined as a service for the purposes of the Sixth VAT Directive: CJEU C-172/96, *Commissioners of Customs and Excise v First National Bank of Chicago*, E.C.R. 1998, I, 4413.

⁴³⁵ See, for instance, the opinion of AG JACOBS in *Alpine Investments*: "*Alpine Investments offers financial services. [...] [T]hose include executing orders on the instruction of clients[...]*". Opinion of Advocate General JACOBS in CJEU C-384/93, E.C.R. 1995, I, 1144, para 9.

⁴³⁶ E.g.: CJEU C-484/93, *Svensson and Gustavsson v Ministre du Logement et de l'Urbanisme*, E.C.R. 1995, I, 3971; CJEU C-279/00, *Commission v Italy*, E.C.R. 2002, I, 1446; CJEU C-155/08 and C-157/08, *X and E.H.A. Passenheim-van Schoot v Staatssecretaris van Financiën*, E.C.R. 2009, I, 5093.

⁴³⁷ E.g.: CJEU C-452/04, *Fidium Finanz v Bundesanstalt für Finanzdienstleistungsaufsicht*, E.C.R. 2006, I, 9562; CJEU C-524/04, *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue*, E.C.R. 2007, I, 2157; CJEU C-492/04, *Lasertec Gesellschaft für Stanzformen mbH v Finanzamt Emmendingen*, E.C.R. 2007, I, 3775; CJEU C-324/00 *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt*, E.C.R. 2002, I, 11779. See also C. BARNARD, *The Substantive Law of the EU: The Four Freedoms*, New York, Oxford University Press, 2007, 554-555.

⁴³⁸ See CJEU C-452/04, *Fidium Finanz v Bundesanstalt für Finanzdienstleistungsaufsicht*, E.C.R. 2006, I, 9562, para 34 and 49.

⁴³⁹ In the same sense see: D.S. SMIT, "The Financial Transaction Tax and the TFEU Freedoms" in O. MARRES and D. WEBER, *Taxing the Financial Sector: Financial Taxes, Bank Levies and More*, Amsterdam, IBFD, 2012, 128 (hereafter: D.S. SMIT, "The FTT and the TFEU Freedoms").

1.2.2 Discrimination

163. Both overt discrimination based on nationality as covert discrimination based on other criteria which have the same practical result (e.g. residence) are prohibited. Discriminatory measures encompass both the differential treatment of equal situations and equal treatment of different situations.⁴⁴⁰ FTTs as such are not discriminatory.⁴⁴¹ They lead to taxation of financial transactions without distinction. FTTs based on the residence principle will lead to taxation of residents and thus simply to a less favourable treatment of residents. Moreover, in tax cases, measures producing a differential treatment are very often assessed through the looking glass of a restriction analysis.⁴⁴²

1.2.3 Restriction

164. Non-discriminatory measures may still infringe free movement if they amount to a restriction. Throughout the years, the CJEU has developed the restriction-based analysis model, which was first introduced for the freedom of goods⁴⁴³ and, subsequently, services⁴⁴⁴, persons⁴⁴⁵ and capital⁴⁴⁶. Indeed, as confirmed in the *Gebhard* case, the restriction notion seems to be universally applicable to all fundamental freedoms. Therefore, restrictive measures are those "*liable to hinder or make less attractive the exercise of fundamental freedoms*".⁴⁴⁷ In cases concerning direct taxation, however, the CJEU seems to use a more restrained approach, which is actually a discrimination analysis in essence, even when purportedly assessing whether a certain measure amounts to a restriction.⁴⁴⁸ In rare cases, a

⁴⁴⁰ D.S. SMIT, "The Financial Transaction Tax and the TFEU Freedoms", see *supra* note 439, 129-130.

⁴⁴¹ See also D.S. SMIT, "The FTT and the TFEU Freedoms", see *supra* note 439, 129-130.

⁴⁴² M. TISON, "Unravelling the General Good Exception. The case of Financial Services", University of Ghent Financial Law Institute Working Paper Series, 2000, 14, www.law.ugent.be/econr/fli/WP/wp2000-03.pdf (hereafter: M. TISON, "General Good Exception").

⁴⁴³ E.g.: CJEU C-8/74, *Procureur du Roi v B. and G. Dassonville*, E.C.R. 1974, 837; CJEU C-120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein*, E.C.R. 1979, 649.

⁴⁴⁴ E.g.: CJEU C-76/90, *M. Säger v Dennemeyer & Co. Ltd*, E.C.R. 1991, I, 4239.

⁴⁴⁵ E.g. CJEU C-19/92, *D. Kraus v Baden-Württemberg*, E.C.R. 1993, I, 1689.

⁴⁴⁶ E.g. CJEU C-358/93 and C-416/93, *Criminal proceedings against A. Bordessa and V. Mari Mellado and C. Barbero Maestre*, E.C.R. 1995, I, 376.

⁴⁴⁷ CJEU C-55/94, *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procurati di Milano*, E.C.R. 1995, I, 4165, para 37.

⁴⁴⁸ E.g.: freedom of establishment cases: CJEU C-141/99, *Algemene Maatschappij voor Investering en Dienstverlening NV (AMID) v Belgische Staat*, E.C.R. 2000, I, 11619; CJEU C-324/00, *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt*, E.C.R. 2002, I, 11779; CJEU C-168/01, *Bosal Holding BV v Staatssecretaris voor Financiën*, E.C.R. 2003, I, 9409; free movement of workers cases: CJEU C-385/00, *F.W.L. de Groot v Staatssecretaris van Financiën*, E.C.R. 2002, I, 11819; free movement of capital cases: CJEU C-35/98, *Staatssecretaris van Financiën v B.G.M. Verkooijen*, E.C.R. 2000, I, 4071; CJEU C-315/02, *Anneliese Lenz v Finanzlandesdirektion für Tirol*, E.C.R. 2004, I, 7063; CJEU C-319/02, *Petri Manninen*, E.C.R. 2004, I, 7477 (even though the Court considered that the concept of a restriction of capital movements corresponds to the concept as developed in cases concerning other freedoms); CJEU C-377/07, *Finanzamt Speyer-Germersheim v STEKO Industriemontage GmbH*, E.C.R. 2009, I, 299. See also concerning the restriction notion in tax cases: J. SNELL, "Non-Discriminatory Tax Obstacles in Community Law", *International and Comparative Law Quarterly* 2007, 339-370 (hereafter: J. SNELL, "Non-Discriminatory Tax Obstacles").

restriction is found in specific procedural features affecting market access.⁴⁴⁹ In contrast, even-handed taxation as such is usually not seen as restrictive, even when it leads to double taxation between Member States.⁴⁵⁰ It is therefore questionable whether the standard restriction language applies to the imposition of a tax in the same way as it does to regulatory measures.

165. The approach in indirect tax cases seems similar, although some cases hint at a possible application of the restriction-based approach (see no. 167).⁴⁵¹ In the *Sandoz* case, however, the CJEU applied a full restriction analysis to an indirect tax measure, at least in words.⁴⁵² In this case, the Austrian stamp duty on loan agreements was at issue. The 0,8 % charge also extended to loans granted by non-residents to residents. The CJEU concluded that this "*deprives residents [...] of the possibility of benefitting from the absence of taxation which may be associated with loans obtained outside the national territory.*"⁴⁵³ Therefore, Austrian stamp duty was "*likely to deter*" residents from obtaining loans abroad and constituted a restriction to the free movement of capital. While *Sandoz* departs from the usual reluctance for an restriction-based approach in tax cases, the CJEU was equally liberal in accepting possible justifications. Therefore, the case does not have a substantial impact on practical outcome and one should be careful not to jump to conclusions.⁴⁵⁴ Indeed, it is questionable whether any form of taxation would escape a strict application of the restriction notion at all.⁴⁵⁵ This seems to be a major underlying reason for the CJEU's restrained approach.

166. In a rigorous application of the restriction formula, as supported by *Sandoz*, the mere imposition of FTT amounts to a restriction of capital movements, since the increased transaction costs would make the exercise of the free movement of capital at least less attractive. However, following CJEU case law relating to tax measures, a low-rate tax on securities transactions as such is not a

⁴⁴⁹ CJEU C-250/95, *Futura Participations SA and Singer v Administration des contributions*, E.C.R. 1997, I, 2471 (carrying forward of losses subject to condition of maintaining separate accounts relating to activities within a Member State); CJEU C-433/04, *Commission v Belgium*, E.C.R. 2006, I, 10653 (see no. 187). See N. BAMMENS, *The Principle of Non-discrimination in International and European Tax Law*, Amsterdam, IBFD, 2012, 562 (hereafter: N. BAMMENS, *Non-discrimination*).

⁴⁵⁰ CJEU C-513/04, *Mark Kerckhaert and Bernadette Morres v Belgische Staat*, E.C.R. 2006, I, 10967; CJEU 194/06, *Staatssecretaris van Financiën v Orange European Smallcap Fund BV*, E.C.R. 2008, I, 3747; CJEU C-128/08, *Jacques Damseaux v Belgische Staat*, E.C.R. 2009, I, 6823.

⁴⁵¹ See e.g.: CJEU C-544/03 and C-545/03, *Mobistar v Commune de Fléron and Belgacom v Commune de Schaerbeek*, E.C.R. 2005, I, 7723. J. SNELL, "Non-Discriminatory Tax Obstacles", see *supra* note 448, 348.

⁴⁵² CJEU C-439/97, *Sandoz GmbH v Finanzlandesdirektion für Wien, Niederösterreich und Burgenland*, E.C.R. 1999, I, 7066.

⁴⁵³ See paragraph 19 of the *Sandoz* judgment.

⁴⁵⁴ J. SNELL, "Non-Discriminatory Tax Obstacles", see *supra* note 448, 345-346. See also BAMMENS, who criticizes the judgment and states that the restrictive effect in *Sandoz* was merely the result of interplay of the Member States' different tax system. Indeed, this is exactly the reason why a restriction analysis, which is absolute, is unsuited for tax cases: N. BAMMENS, *Non-discrimination*, see *supra* note 449, 549-550.

⁴⁵⁵ J. SNELL, "Non-Discriminatory Tax Obstacles", see *supra* note 448, 357-358.

restriction on the free movement of capital.⁴⁵⁶ The Commission's LS has expressed a similar opinion.⁴⁵⁷

1.2.4 Disproportionate relation between tax amount and transaction value: the case of the EU 11 FTT

167. As stated above, some case law seems to drive at the assessment of indirect tax measures on the basis of the restriction notion. With the exception of *Sandoz*, however, none of these cases truly departs from traditional tax case law. In *Viacom*, which comes closest, the CJEU considered that an indirect tax on advertising with a tax amount "which may be considered modest in relation to the value of the services provided" was "in those circumstances [...] not liable to prohibit, impede or otherwise make less attractive" the provision of services.⁴⁵⁸ In *De Coster*, AG COLOMER found an indirect tax designed to discourage the use of satellite dishes to be restrictive, pointing towards its "significant sum in relation to the cost of [...] the satellite dish".⁴⁵⁹ The Court, however, did not elaborate on this feature, since it identified a discrimination.⁴⁶⁰ In freedom of goods cases, the question has sometimes arisen whether excessively high tax rates could constitute a measure equivalent to quantitative restrictions on imports in the sense of old Article 28 EC (now 34 TFEU).⁴⁶¹ In *De Danske Bilimportører*, the CJEU held that a non-discriminatory Danish car registration duty oscillating between 105 and 180% of the car's purchase price, "under the circumstances", did not amount to such a measure, quite extraordinarily taking into account statistics showing that car imports were not impeded in practice.⁴⁶² The question therefore arises whether indirect taxes with a disproportionate amount as compared to the value of the transaction are restrictive. Admittedly, case law on this issue is scarce and inconclusive. In the author's view, the mere fact that the tax amount is substantial or even greater than the purchase price is not enough to identify a restriction. However, the Treaty freedoms would lose much significance if taxes, so disproportionate as to result in a virtual prohibition of

⁴⁵⁶ Cf.: D.S. SMIT, "The FTT and the TFEU Freedoms", see *supra* note 439, 134-135; L.A. DENYS, "Is de belasting op financiële transacties (Tobintaks) in strijd met het Europese vrije kapitaalverkeer?", *AFT* 2001, 309 (hereafter: L.A. DENYS, "Tobintaks"); M. TISON, "FTT - considerations from a legal perspective", see *supra* note 292, 17. *Contra*: P. INWINKL and G. HAAG, "Currency Transaction Tax and Its Conformity with the Free Movement of Capital and Monetary Policy", *Steuer und Wirtschaft* 2012, 15 (hereafter: P. INWINKL and G. HAAG, "Currency Transaction Tax"): these authors largely base their conclusion on the *Sandoz* case.

⁴⁵⁷ Commission Services, "Legality of the counterparty-based deemed establishment", see *supra* note 410, 18.

⁴⁵⁸ CJEU C-134/03, *Viacom Outdoor v Giotto Immobilier*, *E.C.R.* 2005, I, 1167, para 38. The Court considered that the fact that the tax only applied to outdoor advertising activities involving the use of public space also played a role in mitigating its effects.

⁴⁵⁹ Opinion of Advocate General RUIZ-JARROBO COLOMER in CJEU C-17/00, *E.C.R.* 2001, I, 9486 [note 167].

⁴⁶⁰ CJEU C-17/00, *F. De Coster v Collège de bourgmestre et échevins de Watermael-Boitsfort*, *E.C.R.* 2001, I, 9445 (hereafter: CJEU C-17/00, *De Coster*).

⁴⁶¹ See also CJEU C-47/88, *Commission v Denmark*, *E.C.R.* 1990, I, 4509. Here, the action was exclusively based on Art. 90 EC, which requires a discrimination. The Court indicated that, provided that the tax amount impedes the free movement of goods, it can be challenged under Art. 20 EC: J. SNELL, "Non-Discriminatory Tax Obstacles", see *supra* note 448, 343.

⁴⁶² CJEU C-383/01, *De Danske Bilimportører v Skatteministeriet*, *E.C.R.* 2003, I, 6065, para 40-42.

transactions, were able to completely escape the CJEU's scrutiny. One might argue that the reasoning underlying the restrained review is not applicable and that the tax measure is, in effect, equal to a regulatory measure.⁴⁶³ In these cases, the distinction with regulatory measures rendering the free movement of capital "illusory" is not immediately clear.⁴⁶⁴ In a somewhat similar sense, SMIT argues that a restriction would only be found in "*exceptional circumstances, for instance if a tax measure were to be tantamount to expropriation*"⁴⁶⁵

168. But when do FTTs have this effect, if ever? Could a tax be considered prohibitive, as opposed to merely substantial, if, *ex ante*, its amount obviously exceeds any possible economic benefit that may be derived from a certain transaction, therefore rendering it economically useless? This was, for instance, not the case in *De Danske Bilimportører*, where car importers still made profits and Danish drivers still valued cars enough to bear the duty. SMIT argues that FTTs render free movement illusory when high-volume, but low margin transactions (which he seems to limit to low-margin speculative trading) are in scope.⁴⁶⁶ It cannot be denied that modern FTTs such as the EU 11 FTT clearly have a regulatory purpose. When taking HFT in isolation, the only difference between imposing a FTT or instituting a ban on automated trading servers is that the former is much more easily enforced. There is also no question that the Commission aims at eliminating or severely discouraging this business model.⁴⁶⁷ In these circumstances, FTTs arguably amount to a restriction insofar as they prevent cross-border capital movements resulting from such trading.

169. FTTs, however, might also affect other low-margin activities: market making, dealer intermediation, repo transactions, buy/sell-backs and securities lending.⁴⁶⁸ Market makers operate on a relatively small bid-ask spread, which could be below tax level in liquid markets. The same is true for

⁴⁶³ These taxes will often have regulatory objectives (*cf.* the FTT). *Cf.* A. CORDEWENER, *Europäische Grundfreiheiten und nationales Steuerrecht: "Konvergenz" des Gemeinschaftsrechts und "Kohärenz" der direkten Steuern in der Rechtsprechung des EuGH*, Cologne, Verlag Dr. Otto Schmidt, 2002, 849-850 who argues that such a tax could amount to an obstacle for market access by non-residents, but indicates that it is far from certain up from which tax rate such a prohibition would exist.

⁴⁶⁴ This terminology is taken from the "golden shares" cases. See e.g.: CJEU C-367/98, *Commission v Portugal*, E.C.R. 2002, I, 4731, para 45. Member States would be able to circumvent fundamental freedoms with relative ease if they were allowed to freely replace genuine non-discriminatory prohibitions by prohibitive tax measures aimed at having the same effect.

⁴⁶⁵ D.S. SMIT, "The FTT and the TFEU Freedoms", see *supra* note 439, 134.

⁴⁶⁶ D.S. SMIT, "The FTT and the TFEU Freedoms", see *supra* note 439, 135 and 140: low-margin trading is that activity which is "*carried out by the "bad guys"*". See also DIETLEIN, who opines that a FTT on high-volume, but low-margin transactions would make the free movement of capital illusory: G. DIETLEIN, "National Approaches towards a Financial Transaction Tax and Their Compatibility with European Law", *EC Tax Review* 2012, 208.

⁴⁶⁷ EC, "FTT - Non-technical answers to some questions on core features and potential effects", http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/faq_en.pdf, 2-3 (hereafter: EC, "Non-technical answers").

⁴⁶⁸ *Cf.* the presentation held by P. SMET on 16 May 2013 who identifies some of the areas where the FTT might have a disproportionate impact: P. SMET, "The (il)legality of the FTT", Presentation, 16 May 2013, 7, [https://vbo-feb.be/Global/Events/16.05.13.Seminar%20FTT%20EU/\(3\)Smet_Allen-Overy_FTT_VBO_seminar_16_May%20%5BCompatibility%20Mode%5D.pdf](https://vbo-feb.be/Global/Events/16.05.13.Seminar%20FTT%20EU/(3)Smet_Allen-Overy_FTT_VBO_seminar_16_May%20%5BCompatibility%20Mode%5D.pdf) (hereafter: P. SMET, "(I)legality of the FTT").

dealers operating on an internalized spread. It would also seem that the effect on this business model is deliberate, in view of limiting the internalization of profits by the financial sector.⁴⁶⁹ In this sense, FTTs may amount to a restriction on transactions resulting from certain market maker or dealer activity. Repos encompass two mirrored transactions executed within a relatively short term and offer only a small margin (the repo rate, which corresponds to the interest rate) to the lender. Even if repos are qualified as one taxable transaction (see no. 48), very low tax rates will still grossly exceed margins on overnight and, depending on interest rates, other short-term lending operations.⁴⁷⁰ EU 11 FTT exacerbates this effect by possibly taxing collateral management and market value (*i.e.* not taking into account the "haircut"). The Commission explicitly acknowledges that overnight repos as they exist today would disappear.⁴⁷¹ In these circumstances, taxation of overnight and possibly other short-term repos is arguably a restriction to the freedom of capital movements. The same would apply to securities lending which is structured in the same way as repos, but with the purpose of lending securities in lieu of cash. Sell/buy-back (or buy/sell-back) transactions are very similar, with the difference that they encompass two separate legal contracts and are often undocumented.⁴⁷² Given that they are economically equal to repos, the above conclusion is applicable. All of these transactions are collectively referred to as securities financing transactions ("SFTs").

170. Some other aspects could lead to taxation which is substantial, but not necessarily prohibitive, as compared to transaction value. Firstly, derivatives could be taxed on notional value (EU 11 FTT), which is sometimes a poor measure for contract value, especially for hedging derivatives. However, EU 11 FTT mitigates this effect by imposing a lower tax rate on derivatives (0,01%). Secondly, cascading effects exacerbate the total tax burden on one transaction from an economic point of view when multiple non-exempted intermediaries interfere. Notwithstanding the implications for the economic analysis of FTT effects, this will generally not lead to a prohibitive and possibly not even substantial tax burden in light of CJEU case law. It will usually not be manifestly clear in advance that the tax amount will exceed the possible value of the transaction.⁴⁷³ Therefore the magnitude of the FTT's effect is too uncertain to render free movement of capital illusory.

⁴⁶⁹ EC, "Non-technical answers", see *supra* note 467, 4.

⁴⁷⁰ ICMA, "Collateral Damage", see *supra* note 57, 15.

⁴⁷¹ EC, "Impact Assessment EU 11 FTT", see *supra* note 43, 29. On the basis of a 250 business day year (which is quite low for repo rate calculation), the Commission calculates that the real tax burden on overnight repos would amount to 25% per annum of nominal value. However, both transaction legs will often be taxed. The real amount is thus, at least, 50% per annum. See EC, "Specific cases", see *supra* note 111, 37.

⁴⁷² See ICMA, "8. What is the difference between a repurchase agreement and a sell/buy-back?", www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/frequently-asked-questions-on-repo/8-what-is-the-difference-between-a-repurchase-agreement-and-a-sell-buy-back/.

⁴⁷³ E.g.: a company enters into a commodity future to hedge against price fluctuations. It is questionable whether a 0,01% charge on the notional value would dissuade it altogether from eliminating the risk of a price fluctuation exceeding 0,01%. The same applies *a fortiori* to speculative derivatives.

171. Concluding, the likeliness of a restriction being found depends on the case law followed. On the one end of the spectrum, we find the restriction notion in non-tax cases and, quite isolated, *Sandoz*. On the other, we find traditional case law in tax cases and its differential treatment approach, albeit marginally leaving an opening for taxes with a disproportionate tax burden to be found restrictive. In this thesis, the position is taken that FTTs as such are not contrary to free movement. They are too much of a tax measure. FTTs on cross-border low-margin trading (e.g. HFT), certain STFs and certain market making and dealing, however, constitute a non-discriminatory restriction, provided that they have a prohibitive, and thus quasi-regulatory, nature. Here, FTTs are too much of a regulatory measure to escape all scrutiny under the Treaty freedoms.

1.2.5 Justification

172. Insofar FTTs are discriminatory or restrictive, a justification may be available based on either specific derogations included in the Treaty or the "rule of reason" as developed by the CJEU. The latter, however, can only be invoked for non-discriminatory measures.⁴⁷⁴

173. Relevant Treaty-based derogations are included in 65 TFEU. Article 65 (1) (a) and (b) will be discussed where relevant (see no. 177 and 184). Article 65 (1) (b) furthermore provides that measures may be justified on the grounds of public policy or security. It is true that FTTs sometimes aim to stabilize financial markets. The CJEU, however, has held that there should be a "*genuine and sufficiently serious threat to a fundamental interest of society*".⁴⁷⁵ It is doubtful whether the supposed harms of speculation qualify.⁴⁷⁶

174. Non-discriminatory restrictions can be justified based on three cumulative conditions: the measure is (i) justified by imperative requirements in the general interest, (ii) suitable for securing the attainment of the objective which it pursues, and (iii) necessary and proportionate, *i.e.* it does not go further than what is necessary in order to attain it.⁴⁷⁷

1.2.5.1 Low-margin speculative trading

175. Firstly, could taxation of low-margin trading activity such as HFT be justified? Restrictions of free movement can only be maintained to attain a general interest which has to be in accordance with

⁴⁷⁴ The non-discriminatory nature of a restrictive measure is a necessary condition in light of the rule of reason.

⁴⁷⁵ CJEU C-54/99, *Association Eglise de Scientologie de Paris and Scientology International Reserves Trust v The Prime Minister*, E.C.R. 2000, I, 1361, para 17.

⁴⁷⁶ P. INWINKL and G. HAAG, "Currency Transaction Tax", see *supra* note 456, 15.

⁴⁷⁷ See e.g. CJEU C-55/94, *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procurati di Milano*, E.C.R. 1995, I, 4197-4198, para 37.

the wording and intent of the Treaty.⁴⁷⁸ FTTs come with a variety of objectives. It is doubtful whether FTTs which merely aim to raise revenue can be justified on these grounds.⁴⁷⁹ Justifications connected to tax revenue are normally not recognized by the CJEU, as are purely economic grounds in general.⁴⁸⁰ The same is probably true for objectives such as demanding a fair contribution from the financial sector.⁴⁸¹ Ensuring the stability of the financial markets and sector, on the other hand, will most likely qualify as an overriding general interest.⁴⁸² Similarly, the CJEU has accepted maintaining the good reputation of the national financial sector as an imperative reason of public interest, since financial markets "*play an important role in the financing of economic operators*".⁴⁸³ The second step is to assess whether taxation of said trading activity is suitable to ensure the stability of financial markets. The issue bears relation to the current economic discussion on the effectiveness of FTTs in reducing asset bubbles and systemic risk (see no. 20). It is clear that opinions among economists vary greatly. Notwithstanding the merits of the arguments made by opponents, the CJEU will most likely be weary of interfering with the competences of the national and, especially, EU legislator in appreciating economic facts. As long as the effectiveness of FTTs is plausible and not inconceivable, it is for the legislator to appreciate their adequacy. The CJEU's restraint in assessing economic facts and analyses in action for annulment cases is illustrative in this regard.⁴⁸⁴ When following this logic, FTTs will be deemed suitable to ensure financial stability, given that an important number of notable economists and professional investors recognize their effectiveness.⁴⁸⁵ Finally, is imposing a FTT on this activity proportionate? The question is whether less restrictive measures exist which would equally attain the objective. Possible tax alternatives have been dealt with elsewhere in this thesis. As far as these are aimed at stabilizing the financial markets, however, they primarily target excessive leverage or profits made by financial institutions in general. In this respect, the FTT's impact on high-frequency trading and other short-term speculative transactions is quite unique. It is unlikely that measures less restrictive than low-rate FTTs would be available to combat such transactions and, therefore, it would seem that they are proportionate to this cause.

⁴⁷⁸ M. TISON, "General Good Exception", see *supra* note 442, 12-13.

⁴⁷⁹ In fact, this is probably an important reason for the CJEU's restrained approach towards tax cases. Since most taxes only have a revenue-raising objective, qualifying taxes as such as restrictions would effectively lead to the inconformity of most non-discriminatory taxes entailing cross-border effects with primary EU law. J. SNELL, "Non-Discriminatory Tax Obstacles", see *supra* note 448, 358.

⁴⁸⁰ E.g.: CJEU C-35/98, *Staatssecretaris van Financiën v B.G.M. Verkooijen*, E.C.R. 2000, I, 4071, para 59; M. TISON, "General Good Exception", see *supra* note 442, 12.

⁴⁸¹ Cf. D.S. SMIT, "The FTT and the TFEU Freedoms", see *supra* note 439, 139.

⁴⁸² F.C. MAYER and C. HEIDFELD, "Europarechtliche Aspekte einer Finanztransaktionsteuer", *EuZW* 2011, 378 (hereafter: F.C. MAYER and C. HEIDFELD, "Finanztransaktionsteuer").

⁴⁸³ CJEU C-384/93, *Alpine Investments BV v Minister van Financiën*, E.C.R. I, 1179, para 42 and 44.

⁴⁸⁴ K. LENAERTS and D. ARTS, *Europees Procesrecht*, Antwerp, Maklu, 2003, 247.

⁴⁸⁵ Cf. D.S. SMIT, "The FTT and the TFEU Freedoms", see *supra* note 439, 140. *Contra*: G. DIETLEIN, "National Approaches towards a Financial Transaction Tax and Their Compatibility with European Law", *EC Tax Review* 2012, 209.

1.2.5.2 Other low-margin market practices

176. The taxation of STFs cannot be justified on the grounds of financial market stability. It is true that STFs play a part in shadow banking, given that they provide a functional equivalent for other short-term financing operations (e.g. deposits), and that such activity entails a significant amount of systemic risk.⁴⁸⁶ Prohibitive taxation of STFs, however, will not necessarily lead to the disappearance of these risks. To the contrary, market participants may switch to untaxed alternatives. Repos, for instance, provide for securitized loans with high value collateral. The Commission identifies a pledge of collateral, deposits and unsecured lending as untaxed alternatives.⁴⁸⁷ Uncollateralized transactions impose additional risk.⁴⁸⁸ In systems where immediate sale or even appropriation of pledged securities is allowed, collateral of similar value may be available, but this would still not mean that STFs are suitable, because the same risks would exist when short-term loans with pledges of securities or cash are used. The fact that central bank liquidity provision through repos is left untaxed, does not alter this conclusion. Finally, the Union legislator clearly accepts that the disappearance of alternative short-term financing arrangements is not desirable.⁴⁸⁹ These are important for, *inter alia*, short-term liquidity management necessary to mitigate liquidity risk. Prohibitive taxation of STFs is thus probably not suitable and at least not proportionate to attain a higher financial stability.

177. The Impact Assessment with the EU 11 FTT, however, mentions another possible reason for repo taxation: non-taxation of overnight repos would lead to loopholes, since repos with longer maturities could be disguised as overnight repos.⁴⁹⁰ More generally, exemptions for repos may generate avoidance opportunities. According to the BIS, repo settlement is conducted through the securities and payment settlement systems used for regular security purchases in many countries. Most CSDs, however, might not be in a position to distinguish repos from regular transactions.⁴⁹¹ This reason can be translated into primary EU law in two different ways. Firstly, Article 65 (1) (b) TFEU, which *inter alia* allows requisite measures which prevent infringements of national tax laws, may be applicable. Secondly, the effectiveness of fiscal supervision and prevention of tax evasion may also constitute imperative reasons in a rule of reason analysis. The CJEU is usually reluctant in allowing this justification, considering, for instance, that a general presumption of tax evasion or disadvantages

⁴⁸⁶ EC, "Green Paper: Shadow Banking", COM(2012) 102 final, 5, http://ec.europa.eu/internal_market/bank/docs/shadow/green-paper_en.pdf.

⁴⁸⁷ EC, "Specific cases", see *supra* note 111, 35-36.

⁴⁸⁸ In the past, the EU has adopted legislation specifically aimed at harmonizing the use and enhancing the legal certainty connected to financial collateral throughout the EU: Directive Parl. No. 2002/47/EC, 6 June 2002 on financial collateral arrangements, *OJ. L.* 27 June 2002, 168, 43.

⁴⁸⁹ Explanatory Memorandum Proposal for a Regulation of the European Parliament and of the Council on reporting and transparency of securities financing transactions, COM(2014) 40 final, 3.

⁴⁹⁰ EC, "Impact Assessment EU 11 FTT", see *supra* note 43, 29.

⁴⁹¹ BIS, "Strengthening repo clearing and settlement arrangements", September 2010, 19, www.bis.org/publ/cpss91.pdf.

of a purely administrative nature do not suffice.⁴⁹² Assuming for a moment that the justification would be allowed, a broader tax scope (*i.e.* including repos) is a suitable method for preventing tax avoidance. But is it proportionate? Many jurisdictions with FTTs exempt repos and securities lending (e.g. France, Italy, Ireland, and the UK). This is not as such decisive, because in CJEU case law the existence of less strict measures in other states does not necessarily imply that a measure is not proportionate.⁴⁹³ Specifically for EU 11 FTT, it is recalled that repurchase agreements are deemed to give rise to only one taxable transaction, which implies that, in any case, the EU 11 FTT needs to be able to distinguish repos from other transactions to grant this benefit. Moreover, the EU is currently preparing legislation which would require transaction reporting of *inter alia* repos to trade repositories.⁴⁹⁴ Consequently, in the author's view, EU 11 FTT is not proportionate in light of CJEU case law insofar repos are taxed for risk of avoidance of the tax on securities transfers in general. The question then remains in how far the CJEU would be willing to entertain the argument put forth in the Impact Assessment concerning the substitution of repos with longer maturities by those with shorter maturities. Repos are short-term instruments *par excellence* and the vast majority of the market is already made up of repos with maturities shorter than 3 months.⁴⁹⁵ It is the taxpayer who would be required to request relief and provide evidence, for instance when collection is conducted through SSSs.⁴⁹⁶ Tax authorities could then have another, less restrictive, instrument in challenging suspiciously long consecutive runs of overnight repos: the GAAR. Another less restrictive possibility is to divide the tax rate on the basis of days to maturity to make the FTT neutral towards maturity.⁴⁹⁷ All of these elements support the argument that the restrictive measure is not proportionate. The conclusion is probably the same for securities lending, given the close ties with repo transactions. There is, however, a stronger case for taxation of undocumented buy/sell-backs. For these instruments, parties cannot evidence the purpose of the individual transactions and could, *post factum*, classify them as part of a buy/sell-back operation.

178. From the several documents accompanying the EU 11 FTT, one could infer that the Commission is aiming for a new market infrastructure, in which intermediation is primarily conducted by traditional brokers, instead of dealers and market makers interposing their own books and

⁴⁹² See *inter alia*: CJEU C-334/02, *Commission v France*, E.C.R. 2005, I, 2229, para 27 and 29; CJEU C-478/98, *Commission v Belgium*, E.C.R. 2000, I, 7587, para 45.

⁴⁹³ CJEU C-384/93, *Alpine Investments BV v Minister van Financiën*, E.C.R. I, 1179, para 51.

⁴⁹⁴ Art. 4 Proposal for a Regulation of the European Parliament and of the Council on reporting and transparency of securities financing transactions, COM(2014) final. Info on maturity will be available (Art. 4 (7) (b)).

⁴⁹⁵ E.g.: 74,3% in the main survey and 98,3 % of the electronically traded repos through automatic repo trading systems according to the December 2013 survey by ICMA: ICMA, "European repo market survey: Number 26 - conducted December 2013", January 2014, 26, www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/repo/latest/.

⁴⁹⁶ This might be an element to conclude that recourse to the imperative reason of effective fiscal supervision is not available: M. TISON, "General Good Exception", see *supra* note 442, 20-21.

⁴⁹⁷ E.g. a 0,1% FTT charge on an overnight repo would then become 0,0004% (1/250 x 0,1). Jurisdictions could factor in a low amount of business days (here: 250) in comparison with market practice to limit avoidance.

internalizing spreads.⁴⁹⁸ Liquidity provided by the latter is regarded to be excessive. In light of the argumentation above such a feature could be justified under the rule of reason. However, it is surprising that no explicit reference is made to this objective in the Proposal or its Explanatory Memorandum.⁴⁹⁹ Furthermore, this objective does not sit well with recent EU legislation, where liquidity provision by market makers is seen as essential for market efficiency (e.g. the SSR market making exemption).⁵⁰⁰ It is clear, however, that taxation of proprietary trading is pivotal to the objectives of the EU 11 FTT. In this sense, full taxation of dealing and market making activity could be necessary to ensure the effectiveness of fiscal supervision. The fact that jurisdictions often provide for exemptions as such does not mean that providing for no exemption would be disproportionate, particularly since these exemptions have in fact lead to loopholes for proprietary trading (see no. 75). Moreover, it could be argued that closing loopholes is necessary *in function of* the objective to ensure financial stability, since widespread avoidance by financial firms would severely undermine FTT effects.⁵⁰¹ In these circumstances, the balance may very well shift in favour of a justification. However, as stated above (see no. 82), the question still remains whether a very strict exemption for traditional market making would not be more proportionate in light of the harm to market liquidity.

1.3 FTTs with specific features

1.3.1 Spot foreign exchange and derivatives

179. It is emblematic that EU 11 FTT does not include spot currency transactions. The EU institutions have traditionally been circumspect in their approach towards taxation of currency transactions and its conformity with Treaty freedoms.⁵⁰² EU 11 FTT, however, does tax FX derivatives. A recent legal opinion by the Council's Legal Service argues that CTTs are in accordance with free movement.⁵⁰³

⁴⁹⁸ EC, "Non-technical answers", see *supra* note 467, 4-5; EC, "Impact Assessment EU 11 FTT", see *supra* note 43, 20.

⁴⁹⁹ P. SMET, "(II)legality of the FTT", see *supra* note 468, 8: "*stopping the market making business is not a stated objective of the FTT*".

⁵⁰⁰ See Recital (26) of the Short Selling Regulation: "[M]arket making activities play a crucial role in providing liquidity. Imposing requirements [...] could [...] have a significant adverse impact on the efficiency of the Union markets."

⁵⁰¹ See for instance *Alpine Investments*, where the protection of consumers was considered to be necessary to maintain trust in financial markets: CJEU C-384/93, *Alpine Investments BV v Minister van Financiën*, E.C.R. I, 1179.

⁵⁰² See also EC, "Impact Assessment EU FTT", see *supra* note 5, Annex 7, 5.

⁵⁰³ Legal Service of the Council, "Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (FTT) - compatibility with the Treaty provisions of the inclusion of spot currency transactions within the scope of the proposal", 14 March 2014, 10 p., available at <http://blogs.ft.com/brusselsblog/files/2014/03/CLS-Opinion-FX.pdf> (hereafter: Council Legal Service, "Spot currency transactions").

180. CJEU case law does not make a distinction between currency transactions and other forms of capital movements.⁵⁰⁴ Accordingly, when taken in isolation, the aforementioned analysis applies and low-rate taxation of FX transactions is not in breach of free movement. CTTs are therefore not as such in breach of primary EU law. A specific trait of spot and derivative currency transactions, however, is that they have a very strong connection to underlying transactions between different currency areas in financial markets or in the real economy.⁵⁰⁵ For example, when a contractor resident in France receives GBP relating to contracts completed in the UK, he may enter into a spot currency transaction exchanging GBP for EUR or he may have concluded a currency forward agreement in advance to hedge against foreign exchange risk. In this, currency transactions are very closely connected to cross-border payments, which are in turn closely connected to other fundamental freedoms such as the free movement of services and goods.⁵⁰⁶ Current payments enjoy free movement in the EU (Article 63 (2) TFEU), but are generally seen as an accessory of capital movements or movements of goods or services.⁵⁰⁷

181. Given the close relationship between FX transactions and cross-border payments, the ECB (in the context of the Belgian CTT) has, together with some authors, indicated that there may be a problem of discrimination of the latter as compared to purely domestic payments when currency transactions are taxed.⁵⁰⁸ As indicated above, discrimination may be either overt, *i.e.* a formal distinction based on nationality, or covert, *i.e.* a distinction based on a different criterion having the same effect in practice. Different treatment as such is not enough, a measure must treat the protected category (e.g. foreign residents) less favourably than the category to which it is compared.⁵⁰⁹ CTTs do not institute any formal distinction on the basis of nationality and are therefore not overtly discriminatory.⁵¹⁰ The question remains whether a criterion is to be identified which would lead to a covert discrimination (e.g. residence). As concerns taxability, there is no unfavourable treatment of non-residents as compared to residents. The former could be exempted or subject to the tax in exactly the same way as residents. There is, however, a possible element of discrimination on another level: entirely domestic payments will never incur any (indirect) tax liability, but cross-border payments between two currency areas will at some point.

⁵⁰⁴ Council Legal Service, "Spot currency transactions", see *supra* note 503, 6.

⁵⁰⁵ L.A. DENYS, "Tobintaks", see *supra* note 456, 310.

⁵⁰⁶ A series of (older) judgments has demonstrated the relation between restrictions to cross-border payments and these other freedoms: see e.g. CJEU C-286/82 and C-26/83, *Luisi and Carbone v Ministero del Tesoro*, E.C.R. 1984, 377; CJEU C-95/81, *Commission v Italy*, E.C.R. 1982, 2187. See also concerning this relation: J.A. USHER, "The Evolution of the Free Movement of Capital", *Fordham International Law Journal* 2007, 1539 *et seq.*

⁵⁰⁷ L.A. DENYS, "Tobintaks", see *supra* note 456, 311.

⁵⁰⁸ ECB, "Opinion tax on foreign exchange", see *supra* note 15, 4-5; D.S. SMIT, "The FTT and the TFEU Freedoms", see *supra* note 439, 131; F.C. MAYER and C. HEIDFELD, "Finanztransaktionsteuer", see *supra* note 482, 378.

⁵⁰⁹ N. BAMMENS, *Non-discrimination*, see *supra* note 449, 564.

⁵¹⁰ Cf. P. INWINKL and G. HAAG, "Currency Transaction Tax", see *supra* note 456, 13.

182. As pointed out above, a large part of the body of CJEU case law concerning (direct) tax employs a restriction-based analysis, but is effectively based on grounds of differential treatment. BAMMENS calls these cases "*discrimination cases in disguise*" and indicates that they differ from traditional discrimination cases in that the comparison is no longer made on the basis of nationality or, indirectly, on the basis of residence, but between a person exercising the right to free movement and a person not exercising such right.⁵¹¹ Indeed, when analyzing tax cases, this is clearly a recurring approach.⁵¹² Do CTTs create a distinction unfavourable to persons who exercise their right to make cross-border payments in the light of movements of services, goods or capital as compared to those who make purely domestic payments? The criterion for the applicability of CTTs is the conclusion of a currency transaction. In CJEU case law, the use of certain "inconspicuous" criteria may indirectly lead to a distinction on the basis of a cross-border element.⁵¹³ In practice, payments between currency areas will generally be accompanied by a currency transaction, whereas a currency transaction is arguably only in a minority of cases accompanied by a cross-border payment.⁵¹⁴ It could therefore be advanced that the connection between both is not strong enough. One may try to infer this position from the Council LS's opinion. However, the LS itself admits that "[a]rguably, the taxation of spot currency transactions ancillary to underlying operations could be regarded as materially restricting[...]."⁵¹⁵ The LS therefore does not truly give an answer and necessarily limits its conclusion to taxation of currency transactions "*in abstracto*".⁵¹⁶ The question is whether the above is relevant when it is clear that the CTT leads to a more disadvantageous treatment of payments between different currency areas, especially in light of the more recent "differential treatment" case law.⁵¹⁷ In this regard, domestic payments will never indirectly attract CTT, whereas payments between currency areas generally will. In the author's view, this will be the case for CTTs applicable to spot currency

⁵¹¹ N. BAMMENS, *Non-discrimination*, see *supra* note 449, 546.

⁵¹² See most of the cases mentioned in note 448. E.g.: CJEU C-35/98, *Staatssecretaris van Financiën v B.G.M. Verkooijen*, E.C.R. 2000, I, 4071 and CJEU C-315/02, *Anneliese Lenz v Finanzlandesdirektion für Tirol*, E.C.R. 2004, I, 7063 (difference between residents choosing to hold shares in companies established abroad and those who do not).

⁵¹³ See for instance *Eurowings*, where the Court concluded that a difference based on the question whether a lessor was subject to German trade tax or not is in fact a difference based on a cross-border element, since most German lessors are subject to trade tax and no foreign lessors are: CJEU C-294/97, *Eurowings Luftverkehrs v Finanzamt Dortmund-Unna*, E.C.R. 1999, I, 7447.

⁵¹⁴ According to DENYS (2001) some accounts estimate that only 5% of currency transactions have a counterpart in the real economy: L.A. DENYS, "Tobintaks", see *supra* note 456, 310. The exact number depends on how far one is willing to include inter-dealer transactions with intermediary nature and to accept that the volume of the FX market is exaggerated by the use of FX derivative notional value in calculations. In any case, the foreign exchange market is exponentially larger than the real economy: D. SCHÄFER, "Financial Transaction Tax", see *supra* note 45, 77 (15 times larger than global GDP).

⁵¹⁵ Council Legal Service, "Spot currency transactions", see *supra* note 503, 6.

⁵¹⁶ Council Legal Service, "Spot currency transactions", see *supra* note 503, 6.

⁵¹⁷ See, for instance, *De Coster*, where the fact that foreign broadcasters have as an only option the use of satellite dishes, but domestic broadcasters have access to the cable network was sufficient to conclude that a tax on the use of satellite dishes puts the former in a disadvantageous position: CJEU C-17/00, *De Coster*, see *supra* note 460.

transactions and maybe even currency futures/forwards if they lead to a physical transfer of currencies (currently in scope of EU 11 FTT), but probably not for other FX derivatives.

183. If a differential treatment were to be identified, this is not enough to conclude that a measure is discriminatory. The situations between which a distinction is made should be objectively comparable.⁵¹⁸ DENYS points at the important differences flowing from the necessity of foreign exchange (e.g. exposure to foreign exchange risk, possibility of speculation, etc.).⁵¹⁹ Some authors have identified that in CJEU direct tax case law, the Court in fact first examines whether the cross-border situation is treated disadvantageous as compared to the domestic situation and, only in a second phase, conducts a comparability test, in which it takes into account the objectives of the measure, *i.e.* whether the disadvantage can be explained by a (legitimate) objective.⁵²⁰ In this sense, the comparability test sometimes partly coincides with the justification phase. This is likely to be the approach for the CTT. A true comparability test is difficult to conduct, since it is not immediately clear why alleged differences, such as the possibility of speculation, should constitute the objective difference allowing for taxation, without having regard to possible justificatory grounds.

184. If a covert discrimination or restriction (*cf.* tax case law above) were to be found, would a justification be possible? Discriminations can in principle only be justified on the basis of Treaty provisions. Article 65 (1) (a) TFEU allows for tax laws to distinguish on the basis of residence or place where capital is invested. The CJEU has limited the impact of this provision holding that it allows unequal treatment, but, pursuant to Article 65 (3) TFEU, not arbitrary discrimination. Therefore, "*the difference in treatment must concern situations which are not objectively comparable or be justified by overriding reasons in the general interest*" and must be proportionate.⁵²¹ This provision adds little to the present analysis. In tax cases a rule of reason justification is often allowed, precisely because a restriction-based approach is taken. But even when a covert (or indirect) discrimination is found, the CJEU sometimes allows recourse to the rule of reason.⁵²² Stability of the foreign exchange markets⁵²³ or effective fiscal supervision and prevention of evasion could then qualify as overriding interests. The main question is whether the measure is proportionate, since currency transactions connected to the real economy could be exempted or tax could be refunded. Accordingly, one could argue that it would at least be possible and less restrictive to allow tax refunds

⁵¹⁸ N. BAMMENS, *Non-discrimination*, see *supra* note 449, 549.

⁵¹⁹ L.A. DENYS, "Tobintaks", see *supra* note 456, 308.

⁵²⁰ S. DOUMA, *Optimization of Tax Sovereignty and Free Movement*, Amsterdam, IBFD, 2011, 286.

⁵²¹ CJEU C-319/02, *Petri Manninen*, *E.C.R.* 2004, I, 7477, para 28-29.

⁵²² CJEU C-388/01, *Commission v Italy*, *E.C.R.* 2003, I, 721, para 21. See F.C. MAYER and C. HEIDFELD, "Finanztransaktionsteuer", see *supra* note 482, 378.

⁵²³ In the older case *Commission v Italy*, the Court dismissed "defending national currency" as a general interest, since it was a reason of an economic nature: CJEU C-95/81, *Commission v Italy*, *E.C.R.* 1982, 2187. However, this case predates the EMU and protectionist measures in favour of the national currency were still a fresh memory.

when market participants provide evidence of an entirely corresponding non-speculative transaction in the real economy.⁵²⁴ This may be more difficult for some payments connected to capital movements, but less so for payments connected to movements of services or goods. Therefore, in the author's opinion, the legality of CTTs is much less certain than the Council's Legal Service maintains.

185. As a final note, the imposition of a prohibitively high Spahn tax rate will, in the light of the position taken above, most likely constitute a restriction to the free movement of capital. It is difficult to see how such a measure, targeting all spot FX transactions without distinction, could be proportionate.⁵²⁵

1.3.2 EU 11 FTT: 'Contagion' effect and joint and several liability

186. The contagion effect leads to a situation where, when transacting with a resident counterparty, financial institutions resident in another participating Member State are not, but financial institutions resident in a non-participating member state or third country are subject to taxation in the taxing Member State. In the former case, tax is levied by the participating Member State in which the financial institution is resident. Is the fact that rules designating the state competent to collect the tax are different for EU 11 residents and non-residents discriminatory? Since tax rates and other implementing measures might diverge between participating Member States, the Council's LS considers the contagion effect to be discriminatory.⁵²⁶ However, this will not be sufficient to conclude that financial institutions established outside the EU 11 area are generally treated less favourably. As the Commission's LS rightly submits, there is no discrimination as to the fact that FTT becomes due and mere disparities between states in tax rates resulting from the exercise of tax sovereignty are not contrary to fundamental freedoms under current case law.⁵²⁷ The Legal Service further adds that this situation may lead to double taxation of residents in non-participating states and therefore distort capital movements.⁵²⁸ However, under current CJEU case law, this would not constitute a restriction (see no. 164).

187. The contagion effect itself is a rule of substantive tax law, for which a restriction analysis is less suitable. However, the rule imposing joint and several liability on all parties (even individuals) to the transaction may be qualified as a procedural tax rule, for which CJEU tax case law is less reluctant to conduct a full restriction-based analysis⁵²⁹ More specifically, the rule may impede market access for

⁵²⁴ See for such a system: S. SCHULMEISTER, "Strong Pros, Weak Cons", see *supra* note 49, 89.

⁵²⁵ See P. INWINKL and G. HAAG, "Currency Transaction Tax", see *supra* note 456, 16.

⁵²⁶ Council Legal Service, "Legality of the counterparty-based deemed establishment", see *supra* note 414, 9-10.

⁵²⁷ See also Commission Services, "Legality of the counterparty-based deemed establishment", see *supra* note 410, 16.

⁵²⁸ Council Legal Service, "Legality of the counterparty-based deemed establishment", see *supra* note 414, 10.

⁵²⁹ N. BAMMENS, *Non-discrimination*, see *supra* note 449, 562.

foreign financial service providers. In the author's opinion, the fundamental freedom primarily at stake is the free movement of services. The risk of being held liable for the counterparty's tax debt affects users of brokerage services and not necessarily cross-border capital movements. Any effect on the latter would be a secondary consequence of the effect on the former. For example, a French resident willing to invest in French shares (no cross-border capital movement) might be discouraged in the choice for a foreign broker because of the risk of liability. If free movement of services is at stake, this implies that the following analysis only applies in relations between participating Member States and non-participating Member States (and not third countries). In *Commission v Belgium*, a non-discriminatory Belgian rule which obliged principals and contractors having recourse to the services of unregistered (sub)contractors to withhold 15 % of the payable sum and, moreover, made them jointly and severally liable for the latter's tax debts was at issue. The CJEU found both requirements to each individually constitute a restriction to the free provision of services, given that they render market access "difficult" for foreign service providers.⁵³⁰ But even when joint and several liability would be assessed from the viewpoint of differential treatment, there would be a problem.⁵³¹ Residents of the EU 11 area seeking the services of financial firms within the EU 11 area will, in reality, bear little risk of being held liable, because tax authorities can directly enforce on the financial institutions concerned. When turning to financial firms outside the EU 11 area, however, there is a greater chance that tax authorities make use of joint and several liability to avoid enforcement difficulties. Hence, persons exercising their right to free movement of services are effectively treated less favourable than person who do not.

188. A possible justification is the need for effective fiscal supervision and prevention of tax evasion, the latter of which can, on the basis of Article 65 (1) (b) TFEU also be invoked in case of a discriminatory measure. The Commission's LS refers to *Scorpio Konzertproduktionen* to argue that imposing liability on a resident counterparty to cope with difficulties in recovering taxes from non-resident taxpayers can be justified on this basis.⁵³² In this case, however, the CJEU took into account "that at the material time no Community directive or any other instrument [...] governed mutual administrative assistance concerning the recovery of tax debts".⁵³³ Today, the Tax Recovery Directive is applicable. In cases where not tax recovery, but difficulties in gathering information abroad is involved, the CJEU often takes a strict stance, deeming the EU system of mutual administrative

⁵³⁰ CJEU C-433/04, *Commission v Belgium*, E.C.R. 2006, I, 10653, para 31-32.

⁵³¹ See also N. BAMMENS, *Non-discrimination*, see *supra* note 449, 562 who indicates that the judgment in *Commission v Belgium* could also have been rendered on discrimination grounds.

⁵³² CJEU 290/04, *Scorpio Konzertproduktionen v Finanzamt Hamburg-Eimsbüttel*, E.C.R. 2006, I, 9641; Commission Services, "Legality of the counterparty-based deemed establishment", see *supra* note 410, 17.

⁵³³ CJEU 290/04, *Scorpio Konzertproduktionen v Finanzamt Hamburg-Eimsbüttel*, E.C.R. 2006, I, 9641, para 36.

assistance to be sufficient for effective tax supervision, irrespective of its success in practice.⁵³⁴ Even though these cases often involve tax benefits, for which the taxpayer would have a clear incentive to extend information to the tax authorities, this would not necessarily undermine the relevance of this case law when arguing that the current tax recovery regime renders the measure disproportionate.⁵³⁵ The final outcome therefore depends on the evaluation by the CJEU of the recent Tax Recovery Directive.⁵³⁶ To the knowledge of the author, case law on this matter is not (yet) available.

2 Article 113 TFEU and the EU 11 FTT

189. In general, taxation is a competence of the Member States. However, particularly in the field of indirect taxation several EU harmonization measures exist.⁵³⁷ Article 113 TFEU constitutes the basis for EU harmonization of indirect taxation, which requires unanimity at the level of the Council.⁵³⁸ Article 113 encompasses two substantive requirements: first, the measure should be directed at harmonization and second, this is only possible "*to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.*" A European FTT should therefore be directed at remedying disparities between Member States which are detrimental to the internal market. There is no reason why this requirement should not be applicable to measures adopted pursuant to the enhanced cooperation procedure. Article 20 TEU requires that enhanced cooperation is established "*within the framework of the Union's non-exclusive competences.*" The EU's competence in indirect tax matters is limited to harmonization. Furthermore, the EU 11 FTT Proposal is expressly based on Article 113 TFEU.⁵³⁹

190. There are clear similarities between Article 113 and Article 114 TFEU, the latter of which is the legal basis for approximation of laws measures (fiscal provisions are excluded) on EU level and requires these "*to have as their object the establishment and functioning of the internal market.*" Firstly, is the EU 11 FTT a harmonization measure? Existing FTTs' objective scope is much narrower

⁵³⁴ E.g.: CJEU C-334/02, *Commission v France*, E.C.R. 2004, I, 2229, para 31-33; CJEU C-55/98, *Skatteministeriet v Vestergaard*, E.C.R. 1999, I, 7657, para 26; CJEU C-296/12, *Commission v Belgium*, not yet published, para 44.

⁵³⁵ See CJEU C-155/08 and C-157/08, *X and Passenheim-van Schoot v Staatssecretaris van Financiën*, E.C.R. 2009, I, 5093, para 74. This case did not concern a tax benefit, but enforcement of tax debts. In the hypothesis where tax authorities are not aware of the existence of any information, they cannot be expected to have recourse to the mutual assistance mechanism. Where they are aware, however, recourse to this mechanism would be possible. Consequently, in the latter hypothesis, the litigious tax measure was not justified. Such a distinction cannot be made in case of tax recovery. When tax authorities decide to pursue collection from the resident party, recourse to the Tax Recovery Directive will generally be possible in an intra-EU setting.

⁵³⁶ And possibly also on other alternatives for tax collection abroad: see the argument on making a "business" out of tax collection above.

⁵³⁷ E.g.: the VAT Directive and Capital Duty Directive.

⁵³⁸ The proposed first EU FTT and current EU 11 FTT Directives and the VAT Directive are all based on Art. 113 TFEU.

⁵³⁹ Preamble EU 11 FTT Proposal.

than the one proposed. For instance, FTTs in participating Member States are rarely applicable to derivatives and, when they are, only to derivatives connected to chargeable securities (Italy) or on very specific classes of derivatives (France: CDSs). A broad-based FTT levied on all financial transactions and primarily directed at financial institutions, as currently envisaged, would clearly add something to existing national legislation. In this context, it is illustrative that the Commission itself has considered that "[t]he proposed FTT goes far beyond a simple stock exchange transaction tax of the kind that used to exist or has recently been introduced in some EU Member States".⁵⁴⁰ However, harmonization may also be aimed at preventing the emergence of future differences when these are *likely* to arise.⁵⁴¹ The question is thus whether the adoption of broad steering FTTs is to be expected.⁵⁴² This might be the case, since the request for a broad FTT, based on the EU FTT Proposal, comes directly from the participating Member States.⁵⁴³ In any case, it is difficult for the CJEU to assess the likeliness of the adoption of measures in practice and it might not be willing to decide against the appreciation of the legislator.⁵⁴⁴ Nevertheless, there is clearly a gap between post-crisis FTTs being adopted and the EU 11 FTT. Including spot foreign exchange (currently not the case), however, would probably go too far, since no Member State has a CTT in operation and their adoption is not immediately to be expected.

191. In addition, the CJEU often takes a very flexible approach. The Court has held that Article 114 TFEU, depending on the circumstances, grants the Union legislator "*discretion as regards the most appropriate method of harmonisation for achieving the desired result, especially in fields with complex technical features [...]*".⁵⁴⁵ Accordingly, the Court has sometimes allowed measures which are apparently not harmonizing, but part of a larger harmonizing measure and beneficial to the larger objective of market integration. This case law usually involves the creation or delegation of powers to a European agency (e.g. the recent case on the Short Selling Regulation).⁵⁴⁶ The basic principle, however, remains that the institution of a completely new legal form cannot be based on this Article.⁵⁴⁷ It would be interesting to see whether the CJEU would go a step further in widening the competence base of the Union and extend the flexibility exhibited in the aforementioned case law to the EU 11 FTT, given that the legislator considers that "*[t]he improvement of the operation of the internal market, in particular the avoidance of distortions between the participating Member States requires*

⁵⁴⁰ EC, "Non-technical answers", see *supra* note 467, 1.

⁵⁴¹ CJEU C-377/98, *the Netherlands v Parliament and Council*, E.C.R. 2001, I, 7079, para 15.

⁵⁴² Harmonization would then be preventive. See F.C. MAYER and C. HEIDFELD, "Finanztransaktionsteuer", see *supra* note 482, 376.

⁵⁴³ *Contra*: F.C. MAYER and C. HEIDFELD, "Finanztransaktionsteuer", see *supra* note 482, 375. It should be noted, however, that this article predates even the first FTT proposal and the Italian and French FTTs.

⁵⁴⁴ S. WEATHERILL, "The limits of Legislative Harmonization Ten years after *Tobacco Advertising*: How the Court's Case Law has become a "Drafting Guide"", *German Law Journal* 2011, 838-839.

⁵⁴⁵ CJEU C-66/04, *United Kingdom v Parliament and Council*, E.C.R. 2005, I, 10553, para 45.

⁵⁴⁶ CJEU C-270/12, *United Kingdom v Parliament and Council*, not yet published, para 113-114.

⁵⁴⁷ See for instance CJEU C-436/03, *Parliament v Council*, E.C.R. 2006, I, 3754 where the introduction of a European cooperative society, in addition to national corporate forms was deemed to not be in accordance with Art. 114 TFEU.

that a FTT applies to a broadly determined range of financial institutions and transactions, to trade in a wide range of financial instruments."⁵⁴⁸ This might not be necessary if the case is dealt with on the grounds of "preventive" harmonization or when the EU 11 FTT is initially adopted with a more narrow scope.

192. Secondly, is this harmonization necessary for the functioning of the internal market and avoiding competitive distortions? The existence of multiple FTTs within the internal market, each with different objective and territorial scope is certainly liable to create distortions.⁵⁴⁹ The CJEU has held that Article 114 TFEU only justifies measures "where it is actually and objectively apparent from the legal act that its purpose is to improve the conditions for the establishment and functioning of the internal market."⁵⁵⁰ In light of the EU 11 FTT under enhanced cooperation, not all Member States with FTTs will participate. Of the current participating Member States, Belgium, France and Italy levy FTT and Spain has expressed its intention to do so.⁵⁵¹ Non-participating Member States with some form of taxation on financial transactions include the UK, Ireland, Cyprus, Hungary (not yet in effect), Malta, Poland, Finland and Romania. It is, however, undisputable that EU 11 FTT will, to a large extent, align the systems of at least some Member States and therefore reduce competitive distortions between them.⁵⁵² Due to the increased territorial scope, however, new conflicts will arise. Especially the coexistence of UK SDRT and EU 11 FTT could lead to distortions and double taxation. This would also be the case and even more so, however, when participating Member States were to introduce national FTTs of the same nature. Indeed, this type of issue might be common for measures adopted under enhanced cooperation with a harmonization purpose.⁵⁵³ The question is therefore whether the CJEU would be willing to assess the objective of market integration as limited to the markets of the Member States participating in the enhanced cooperation procedure ("ECP") and to what extent adverse effects on market integration and competitive distortions in the EU as a whole play a role. To safeguard the effectiveness of the ECP, it seems reasonable that the second requirement in Article 113 TFEU is considered to be fulfilled when the measure leads to market integration in the participating Member States and when the substantive requirements of the ECP, which already militate against competitive distortions in the EU as a whole and safeguard the internal market, have been complied with.⁵⁵⁴ The conformity of the EU 11 FTT with the substantive and procedural requirements of the ECP is not discussed in this thesis.

⁵⁴⁸ Recital (4) EU 11 FTT Proposal.

⁵⁴⁹ See Recital (3) EU 11 FTT Proposal.

⁵⁵⁰ CJEU C-217/04, *United Kingdom v Parliament*, E.C.R. 2006, I, 3789, para 42.

⁵⁵¹ See no. 36.

⁵⁵² Cf. J. ENGLISH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 230.

⁵⁵³ See also a similar remark made by H. ZOUREK in House of Lords, "Financial Transaction Tax - Evidence", see *supra* note 331, 10.

⁵⁵⁴ See the substantive requirements for enhanced cooperation in Art. 326 TFEU (*inter alia*: enhanced cooperation shall not undermine the internal market, constitute a barrier or discrimination in trade or distort

3 Legality of national FTTs in participating Member States if EU 11 FTT is adopted

193. Article 15 of the EU 11 FTT Proposal prohibits the participating Member States to maintain or introduce taxes on financial transactions other than EU 11 FTT or VAT. "Financial transaction" is defined in Article 2 (1) (2) of the Proposal and encompasses (i) the purchase and sale of financial instruments before netting or settlement, (ii) transfers between group entities, (iii) the conclusion of derivatives, (iv) the exchange of financial instruments, and (v) repurchase agreements and securities lending. Accordingly, Belgium, France and Italy currently operate taxes on financial transactions in the sense of this provision, which they will not be allowed to maintain (at least not in their current form).⁵⁵⁵ CTTs on spot currency transactions, however, remain possible, since these are not financial instruments in the sense of the EU 11 FTT proposal. Currency derivatives are within the scope of the EU 11 FTT.

4 Issues in FTT design in relation with the Capital Duty Directive

194. Within the EU, the Capital Duty Directive provides for a prohibition on indirect taxes on *inter alia* operations carried out to issue, quote or make available equity and debt securities and restructurings.⁵⁵⁶ Duties on the transfer of securities, however, are still possible.⁵⁵⁷ This last element does not mean that transfer taxes benefit from a derogation from the general prohibition when they are imposed in the course of primary issuance and, presumably, restructurings. The CJEU has declared part of the Belgian stock exchange tax contrary to EU law, holding that the first acquisition of securities immediately upon their issue is an integral part of the issuance operation which cannot be taxed and not a transfer in the sense of the provision on securities transfer taxes.⁵⁵⁸ Prior to 2004, stock exchange tax was due on the allotment of securities to subscribers following issuance and the initial physical delivery of bearer instruments.⁵⁵⁹ In the same sense, the "season ticket" which came due on transfers of UK securities into depositary receipt schemes and clearance services was deemed contrary to the CDD.⁵⁶⁰ The CJEU has thus displayed a broad interpretation of the steps issuance encompasses,

competition between Member States). See J. ENGLISH *et al.*, "FTT Proposal Under the ECP", see *supra* note 54, 247 *et seq.*

⁵⁵⁵ E.g.: Belgian stock exchange tax taxes every sale, purchase and, in general, every transfer of a property interest against consideration of Belgian or foreign public "funds", which include securities (Art. 120 (1) *juncto* 121 (2) WDRT). It therefore applies to purchases and sales of certain financial instruments before netting or settlement.

⁵⁵⁶ Art 5 (1) (e) and (2) CDD.

⁵⁵⁷ Art. 6 (1) (a) CDD.

⁵⁵⁸ CJEU C-415/02, *Commission v. Belgium*, E.C.R. 2004, I, 7228. This judgment was rendered under the application of the predecessor of the recent CDD.

⁵⁵⁹ F. SMETS, "Belasting op financiële transacties", see *supra* note 285, 41.

⁵⁶⁰ CJEU C-569/07, *HSBC Holdings plc and Vidacos Nominees Ltd v HMRC*, E.C.R. 2009, I, 9047; First Tier Tribunal (Tax Chamber) UK 28 February 2012, no. TC/2009/16584, para 320 *et seq.*, www.bailii.org.

considering that "*[t]he issue of securities is not an end in itself, and has no point until those securities find investors.*"⁵⁶¹ Article 6 (1) (a) CDD cannot be used to justify FTTs that become due on any of these steps.

⁵⁶¹ CJEU C-415/02, *Commission v. Belgium*, E.C.R. 2004, I, 7228, para 32.

CONCLUDING REMARKS

"We should recognise that our understanding of some of the issues concerning an FTT is partial, tentative or uncertain. Repeating partial truths or guesses clothed as absolute certainties is simply not conducive to a meaningful debate."

- J. VELLA⁵⁶²

195. These words, although expressed by an opponent, perfectly describe some claims made on both sides in the highly polarized debate surrounding the FTT. One is either a strong supporter or fierce opponent and the divide between both groups is vast. This thesis did not aim to evaluate the economic grounds for the introduction of a FTT. It has, however, attempted to bring some clarity through a comparative and legal analysis.

196. Taxation of financial transactions is certainly not new. Revenue-raising stock exchange taxes and stamp duties have existed and exist throughout the globe. However, these transfer taxes generally have a narrow scope. Moreover, by creating escape clauses for financial firms, they burden non-financial enterprises and, to an even greater extent, retail investors, who generally have little possibility of avoiding the tax. Accordingly, UK SDRT is sometimes informally referred to as the "*old ladies tax*".⁵⁶³ More recent post-crisis FTTs have set out to tax the financial sector, but clearly show similarities with traditional STTs. French FTT is reminiscent of stock exchange taxes and does not extend to debt, unlisted instruments or derivatives. Italian FTT, however, targets derivatives which may be used to avoid taxation of in-scope equity. These taxes leave considerable leeway, partly due to market maker relief, but primarily because of the exclusion of intra-day mirrored trading. The separate charge on HFT may not be able to mitigate this effect. All things considered, EU 11 FTT can rightly be labeled as an unprecedented tax. Its wide objective and territorial scope, combined with a striking absence of exemptions, lead to the tax being imposed on virtually all financial transactions somehow connected with a participating Member State and in which at least one financial institution is involved. Indeed, this is precisely the type of tax supporters advocate, because of its resilience against avoidance, and opponents fear, because of its distortionary propensity. If, in an initial stage or permanently, the EU 11 FTT were to be introduced with a significantly narrower objective scope (*i.e.* only equity and its derivatives), one might question whether it has not degenerated to an "ambitious" stock exchange tax. This would not necessarily be true, since HFT and other proprietary trading in equity will be in scope. In a supporter's view, such a FTT may deflate overzealous equity markets. On the other hand, leaving out debt and a large number of derivatives trading will create additional

⁵⁶² J. VELLA, "The Financial Transaction Tax Debate: Some Questionable Claims", *Intereconomics* 2012, 90.

⁵⁶³ EC, "Non-technical answers", see *supra* note 467, 1.

incentives for substitution, inopportune in light of other elements of systemic risk. Moreover, the project is increasingly losing its essential focus. After the path towards a global, and then EU-wide tax, was left, the EU 11 FTT would now have a much narrower scope. In the author's view, the emphasis has shifted from "introducing a tax with the highest potential for financial sector taxation worldwide" in 2010-2011 towards "introducing a common STT on equity in 11 Member States with a certain potential of becoming a broader FTT in a larger part of the world over time" today. Accordingly, it is doubtful whether such a FTT would be entitled to the label "tax on the financial sector" at all. Some Member States are ardently pushing for the introduction of a FTT. The subject is becoming increasingly politicized, which is not necessarily conducive to good tax design.

197. Two remarks specifically on the EU 11 FTT are appropriate. Firstly, the fear that the ultimate tax burden will befall retail investors and commercial enterprises seems, at least, not completely ungrounded for those instances where FTT becomes due on transactions in the framework of financial services. However, the additional impact may remain somewhat subdued in those countries already levying some kind of STT, which will have to be abolished insofar it targets financial transactions in scope of EU 11 FTT. National legislators should be mindful of cascading and show restraint when setting tax rates. Bearing in mind its objectives, the implementation of the EU 11 FTT should not be used as an opportunity to increase the tax burden on retail investors by using current transfer taxes' rates as an absolute yardstick. Secondly, and perhaps most importantly, broadening the FTT's territorial scope is not sufficient in preventing relocation and trading migration when enforcement abroad is not possible. Many have deemed cooperation on G-20 level to be a prerequisite for the introduction of a FTT. In terms of tax collection, domestic market infrastructure and regulation probably facilitates efficient tax collection, but collection abroad undoubtedly remains problematic for certain instruments.

198. Presumably, FTTs in general and EU 11 FTT in particular are legal in light of customary international law as it is enforced in the EU. Moreover, the notion of taxing financial transactions is not contrary to any Treaty freedom when taking into account CJEU tax case law. Following the same case law, the position is tenable that a FTT may be restrictive when it equates to a prohibition for certain transactions. This thesis identifies low-margin automated trading, certain overnight or other short-term securities financing transactions and market making and dealing on low margins as possibly qualifying. These restrictions may be justified. This is, however, arguably not the case for taxation of repos and securities lending. Another measure included in EU 11 FTT, probably restrictive to free movement of services, is joint and several liability of all parties involved in connection with the counterparty principle. Justification depends on the proportionality of the measure and the CJEU's assessment of the usefulness of the recent Tax Recovery Directive. As concerns the conformity of the inclusion of spot (and possibly even some derivative) currency transactions with free movement,

several opposing arguments exist. However, there is a good chance that the analysis is driven all the way up to an assessment of proportionality, where it is not clear whether the measure will survive. Finally, there are grounds to believe that the current EU 11 FTT is validly based on Article 113 TFEU, at least when taking into account the liberal interpretation given to it by the CJEU. Possible issues in light of the ECP were not analyzed in this thesis. One thing, however, is certain: the introduction of any FTT will not go unnoticed and parties would better prepare for the legal battle that is expected to ensue.

INDEX OF TABLES AND FIGURES

TABLES

Table I - Overview of selected taxes on financial transactions	p. 8-11
Table II - Taxable object: selected FTTs (excluding CTTs)	p. 20-21
Table III - Territorial application of selected FTTs	p. 43-45
Table IV - Tax base selected FTTs on derivatives	p. 51
Table V - Tax rates of selected FTTs (most recent)	p. 53-54

FIGURES

Figure I - Cascade effect	p. 15
Figure II - Operation of CCPs: example	p. 56

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NEDERLANDSE SAMENVATTING VAN DE MASTERPROEF CONFORM ARTIKEL 3.2.3 VAN HET REGLEMENT MASTERPROEF

In de nasleep van de recente financiële crisis klinkt de eis om bijdragen vanwege de financiële sector steeds luider. Enkele belastingen op de financiële sector werden de voorbije jaren voorgesteld of daadwerkelijk ingevoerd. Eén specifieke vorm maakt het onderwerp uit van deze masterproef: de financiële transactietaks ("FTT").

FTTs krijgen reeds lang academische aandacht, onder meer als een taks op valutatransacties (de zgn. "Tobintaks"). Enkele landen, waaronder Frankrijk en Italië, hebben recent FTTs ingevoerd. Daarnaast is een procedure van versterkte samenwerking opgestart tussen 11 Europese Lidstaten om op Europees institutioneel niveau een FTT in te voeren ("EU 11 FTT"). Het belasten van financiële transacties is echter niet nieuw en verschillende landen heffen overdrachtsbelastingen op effectentransacties en in sommige gevallen zelfs bepaalde derivaten of deden dit in het verleden. Deze traditionele FTTs zijn echter zelden gericht op de financiële sector. Integendeel, in de praktijk vallen zij als beursbelasting vaak ten laste van kleine beleggers en niet-financiële ondernemingen. Dit betekent echter niet dat de praktische ervaringen opgedaan bij het heffen van deze taksen niet nuttig kunnen zijn bij het ontwerpen van een FTT gericht op de financiële sector. Het eerste deel van de masterproef omvat een kort historisch overzicht en een analyse van de economische ratio van FTTs, alvorens over te gaan op een uitgebreide rechtsvergelijkende studie van fiscaal-technische kenmerken. Hierbij worden enkele valkuilen geïdentificeerd en worden de verschillen tussen verschillende types duidelijk weergegeven. Uitgebreide aandacht wordt besteed aan marktinfrastructuur en recente regulatoire initiatieven die het heffen van een FTT kunnen vereenvoudigen. Afsluitend wordt de FTT tegenover twee andere vormen van "bankbelasting" geplaatst.

In een tweede deel behandelt deze masterproef de verenigbaarheid van de FTT met het internationaal en Europees recht. Hierbij worden zowel het introduceren van de FTT als principe, als enkele specifieke technische kenmerken getoetst aan de internationale belastingsbevoegdheid en het vrij verkeer van kapitaal. Finaal wordt ook nagegaan hoe het invoeren van FTTs in het algemeen, en de EU 11 FTT in het bijzonder, te verenigen valt met de bevoegdheden die de EU geniet krachtens de Verdragen. Hoewel er zeker problemen rijzen in verband met enkele specifieke kenmerken, is de conclusie dat het invoeren van een FTT op effecten- en derivatentransacties in het algemeen minder juridische hindernissen opwerpt dan sommigen vermoeden. De legaliteit van een valutatransactietaks is echter minder zeker in het licht van de fundamentele beginselen van de interne markt.