Territorial prospects of the European Financial Transaction Tax

A territorial analysis of the Proposed Directive in four different perspectives: Economic, Structural, Legal and Practical

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This dissertation is dedicated to those who have always believed in my aptitudes, even when I queried them, and whose support has made me grow into the best version of myself. My only hope is to make you proud.

To Diogo, for the unconditional love and support.

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The present dissertation solely concerns facts occurred until 30/06/2015

INTRODUCTORY CHAPTER

I - Introduction

The severe economic crisis that we have been living in since 2008 has brewed a new debate on the taxation of the financial sector and the necessity of fiscal consolidation. The economic collapse shed a light on the market's lack of transparency and on its inability to function properly without adequate supervision.[1] This sector is globally percept of being greatly culpable for this economic crisis and, due to the VAT exemption in place, indisputably under taxed. The question "Should taxation play a central role in correcting systemic externalities and in shaping the market's entities toxic behaviour" emerged. The practice of risk externalization by the financial sector has proved to be detrimental, more so, when allied with the financial sector's extensive economic role[2] and the presence of financial institutions qualified as "too big to fail".

In response to the economic crisis, governments have implemented several measures to avoid the collapse of the financial system. The repercussion of government intervention was steep public debt.[3] Due to the absence of a considerable contribution from the financial sector, Member States were forced to increase taxes in other areas. In contrast, the sector has been reporting high levels of profitability over the last two decades, which can be perceived as the outcome of a safety net provided by governments (moral hazard), the lack of financial sector regulation and the absence of adequate taxation.[4] The burden of the financial sector collapse was therefore placed in the public, which raises serious equity concerns. It is estimated that the costs of the crisis for the EU27 was of 15% to 20% of the GDP.[5] Once economic equilibrium is attained,

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[1] See RUUD DE MOOIJ AND GAËTAN NICODÈME (eds), Taxation and Regulation of the Financial Sector (CESifo seminar series. 2014) p. 1.

[2] See SHACKELFORD, DOUGLAS A., SHAVIRO, DANIEL N. AND SLEMROD, JOEL, *Taxation and the Financial Sector,* p. 156 *in* Taxation and the Financial Crisis (Alworth and Arachi eds., Oxford. 2012).

[3] See *Ibid.,* p. 25.

[4] See EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax*, SWD(2013) 29 final (2013), p. 4.

[5] See EUROPEAN COMMISSION, *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts,* COM(2013) 71 final (2013), p. 8.

governments need to recover resources, and take appropriate measures to avoid being in the verge of collapse yet again. With this last objective in mind, on the 28th of September 2011, the European Union Commission assembled a proposal for a Council Directive with the intent of implementing FTT – a Financial Transactions Tax.

The European Commission has established clear objectives for the FTT. First, the strengthening of the Internal Market is achieved by the harmonization of legislation, which will subsequently diminish distortion of competition throughout the European Union. Uncoordinated action is perceived as undesirable, as it encourages relocation and promotes the occurrence of double taxation.[6] Tax neutrality requires coordination.[7] Second, the FTT is alleged to generate an impediment for transactions which do not develop productivity or stability of financial markets. The "polluter pays principle" requires a fair and substantial contribution of financial institutions,[8] consequently this tax seems to follow a backward-looking, revenue raising approach.[9] Third, revenue raised by the FTT will contribute to the creation of own resources for the EU budget. Further, the success of such tax at a regional level, will contribute to a possible future global implementation.[10]

Notwithstanding the opposition to the introduction of a tax, proponents defend FTT's potential. Besides being able to raise high revenues, it will address speculation and diminish high speed, short-term trading, understood as harmful to the functioning of markets. Consequently, a decline in volatility will be accomplished. Opponents who claim that the FTT will have negative effects on markets' efficiency, hypothesize a straight connection between liquidity and efficiency. However, this straight connection is far from settled. Indeed, several authors that perceive liquidity as beneficial up to a certain

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[6] See *ibid.,* p. 10.

[7] See EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax,* p. 3.

[8] See *ibid.,* p. 2.

[9] See DEVEREUX, MICHAEL P., *New Bank Taxes: Why and What Will Be the Effects?,* p. 26 *in* Taxation and Regulation of the Financial Sector (Ruud de Mooij and Gaëtan Nicodème eds., CESifo seminar series. 2014).

[10] See EUROPEAN COMMISSION , *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts,* p. 11.

level, argue that any transaction past that does not contribute to the well-functioning of the sector.[11]

Once it became clear that a unanimous decision on a common system of FTT was not possible, eleven Member States[12] addressed a formal request to the Council declaring their wish of instituting an enhanced cooperation.[13] The Council recognized that the legal preconditions were completed.[14] It was concluded that the implementation of a common system of FTT respects the rights, competences and obligations of non-participating Member States. The proposal is directed at the harmonisation of indirect taxation, in an area which does not belong to the exclusive competence of the Union. Finally, the existence of a uniform tax will not weaken the internal market, as a matter of fact, it will reinforce it. Indeed, the introduction of a transaction tax by an individual Member State, will not contribute to the appropriate functioning of the internal market, avoid distortion of competition, or discipline the financial sector. To summarize, the subsidiarity and proportionality principle will not be disrupted with enhanced cooperation in this matter.[15]

The proposed tax is specific, cumulative and indirect,[16] targeting gross financial transactions before netting. It is characterized by its low tax rates,[17] and broad-base. By

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[11] See for example EUROPEAN COMMISSION, FTT Non-technical answers to some questions on core features and potential effects (2013), p. 5.; SCHULMEISTER, STEPHAN, SCHRATZENSTALLER, MARGIT AND PICEK, OLIVER, A General Financial Transaction Tax: Motives, Revenues, Feasibility and Effects (WIFO. 2008) p. 8.

[12] Which include Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, and Spain.

[13] See Article 20 TEU and Article 329 TFEU.

[14] See Council Decision 2013/52/EU of 22 January 2013, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013D0052.

[15] See EUROPEAN COMMISSION, *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts*, p. 10.

[16] See HENKOW, OSKAR, *The FTT Proposal- An Overview of Legal Issues Arising*, p. 23 *in* Taxing the Financial Sector Financial taxes, Bank Levies and more (Marres, Otto and Weber, Dennis eds., IBFD. 2012).

[17] See EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax*, Article 9- 0, 1% in shares and obligations and 0, 01% for derivatives.

taxing all financial instruments,[18] all financial institutions and markets,[19] tax neutrality is attained. To assure the tax does not negatively affect the financing of institutions and states, and that it does not diminish market efficiency, exemptions were included.[20] Chargeability is born at the moment the transaction is implemented, in other words, when a sale or purchase of financial instruments occurs, or when a modification or conclusion of derivatives agreements takes place.[21] The definition of the taxable amount acquires particular complexity in the case of derivative contracts.[22] In those cases, the taxable base of the FTT is based on the notional amount, mentioned in the contract at the time of the transaction.[23] As for the tax liability itself, the tax is to be paid at both ends of the transaction, if a financial institution is involved at each respective end, hence liability falls solely on financial institutions.

II- Structure

The proposed directive's territorial legitimacy has been questioned by critics, particularly in the light of the introduction of the counterparty principle. The objective of this thesis is to understand the arguments presented by opponents, and ultimately refute those allegations by corroborating the proposal's territorial legality.

The first chapter follows the evolution of International law, concerning matters of territorial sovereignty, and introduces the concept of extraterritorial jurisdiction. The second chapter is divided into four different territorial perspectives of the proposed directive. In this last chapter, an extensive territorial analysis of the proposal is pursued.

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[18] See ROHATGI, ROY, Basic international taxation (London: Kluwer Law International. 2002) p. 561.

[19] See EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax*, Article 2.

[20] See *ibid.,* Article 3 (2) and (4).

[21] See *ibid.,* Article 5.

[22] See ROHATGI, ROY, p. 564.

[23] See EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax*, Article 7.

CHAPTER 1

Sovereignty

Sovereignty highlights the supremacy of governmental institutions internally, while externally it solidifies the state's condition as a legal person. A state is only perceived as a legal person if it has a territorial base.[24] This affirmation highlights how sovereignty is intertwined with the territorial principle.

Jurisdiction is a key concept of sovereignty. As held by Maan the concept of jurisdiction draws the limits of a State's sovereignty and upholds the duty to recognize the same right to other States.[25] It is qualified by Malcom Shaw as the power of a state, under international law, to regulate or otherwise impact upon people, property and circumstances.[26]

Jurisdiction can be divided into three sub-pillars. The first is jurisdiction to prescribe, or to legislate. Second, jurisdiction to adjudicate, which is strictly connected with a country's judicial system. Lastly, jurisdiction to enforce, or execute. A distinction is necessary between enforcement and prescriptive jurisdiction. In the latter, the possibility of creating laws directed at foreign circumstances, is recognized. The same does not apply to enforcement jurisdiction.[27] Maan criticizes this assessment, arguing it is unattainable to regard jurisdiction to legislate private law as unlimited.[28] Harold G.Maier emphasizes the unimportance of this particularity, as the enactment of rules presumes its prospect execution. The author perceives jurisdiction as a matter of degree, a unitary phenomenon with diverse phases of application. As extraterritoriality is an outcome of the idea of jurisdiction, it can also be understood as having dissimilar stages

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[24] See SHAW, MALCOM, International Law (Cambridge University Press 6th ed. 2008) p. 487.

[25] SEE MAAN, FREDERICK A., *The Doctrine of International Jurisdiction: Revisited after Twenty Years*, p. 20 *in* Jurisdiction in International Law (Reisman, Michael W. ed., Ashgate. 1999).

[26] See SHAW, MALCOM, p. 645.

[27] See RYNGOERT, CEDRIC, Jurisdiction in International Law – USA and European perspectives (Katholieke Universiteit Leuven Faculteit Rechtsgeleerdheid. 2007) p. 22.

[28] See MAAN, FREDERICK A., p. 21.

of intensity, depending on its degree of imposition to other states.[29]

Jurisdiction is likewise subdivided into personal, territorial and functional.[30] Personal sovereignty is profoundly linked with nationality, while territorial sovereignty is connected with residence. An economic fiscal attachment is produced once an affiliation between the state and the fiscal subject, through the object of tax located in the taxing state, exists.

The purpose of the following chapter is to, not only examine further sovereignty's and jurisdiction's definition, but likewise to comprehend the different doctrines which outline its limits. Within the concept of jurisdiction, the only significant matter to this thesis is tax jurisdiction. The limitations imposed on the power to tax, especially when dealing with facts which have a link with more than one country, are the core of this chapter. Initially, a short analysis of the Classical International law doctrine in juxtaposition to the Lotus case is accomplished. Additionally, the contributions of the US are considered. These range from the effects doctrine, to the concept of other States interests and finally to the draft of a Restatement. The protective principle is regarded as an additional limitation to the exercise of taxation. The last limitation considered consists of the substantial and genuine connection, which is regarded as the foundation for territoriality in contemporary customary International Law. Lastly, a reference is made to the matter of extraterritorial jurisdiction.

1.1 Jurisdiction to tax

A state's jurisdiction to tax is acknowledged as a feature of statehood or sovereignty, restricted by international law.[31] Jurisdiction is traditionally associated with territory, though this may not always be the case. Even though territorial sovereignty is, still, an essential concept of international law, as a result of technological advances, globalization and the increasing interdependence of States, its importance has been diminishing.[32]

Rules and principles regarded as customary international law integrate the

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29 See MAIER, HAROLD G., *Jurisdictional Rules in Customary International Law*, p. 78 *in* Extraterritorial jurisdiction in theory and practice (MEESSEN, KARL ed., London: Kluwer Law International. 1996).

30 See *ibid.,* p. 23.

31 See ALBRECHT, A.R., *The Taxation of Aliens Under International Law*, p. 148 *in* British Year Book of International Law (Lauterpacht, H. ed., Oxford University Press. 1952).

32 See SHAW, MALCOM, p. 488.

framework which limits States' tax jurisdiction. Custom in contemporary legal systems is regarded as trivial. In international law, the contrary is observed, custom is understood as a dynamic and imperative source of law. Nevertheless, there is no consensus on its value. Its uncertainty is perceived as a weakness, however, the inexistence of a centralised international system requires a source of law as flexible as custom. Custom is composed by two basic elements, material facts and the subjective belief that such behaviour constitutes a legal obligation.[33]

1.1.1. Classical International Law Doctrine and the Lotus Case

Jurisdiction can be perceived in two different manners, the first of which, applied in the Lotus case, proclaims its exercise in the way States see fit unless there is a prohibitive rule. The lack of a general prohibition does not entail the uncontrolled intrusion of States in each other's domestic affairs, it simply acknowledges the legal possibility of concurrent jurisdiction.[34] The second approach, the classical international law doctrine, affirms that States are not authorized to exercise their jurisdiction, unless their action is based in an international legal rule.[35] The latter view is vastly dubious due to the abstract nature of international principles, which seem, at times, to disregard the complexity of reality. Furthermore, the dogma is tainted by the obsolescent perception of state dominion, grounded on a strict and simplistic notion of the territoriality principle.[36] The classical international law doctrine is connected with the principle of non-intervention, by which, States are prohibited from intervening in the domestic affairs of other States.[37]

Although the Lotus case has been heavily criticized, and considered obsolete by some authors, it is still an orientation in matters of jurisdiction, as it is the only judgment where an international court directly ruled on this problem.[38] It successfully exposes why the concept of territorial sovereignty justifies extraterritorial action, and how a general prohibition is inefficient, representing a turning point for advocates of the legality of non-territorial based jurisdiction. The case in question extended the definition of control over

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[33] See *ibid.,* p. 73 et seq.

[34] See MAIER, HAROLD G., p. 67.

[35] See RYNGOERT, CEDRIC, p. 32 et seq.

[36] See MAIER, HAROLD G., p. 83 et seq.

[37] See RYNGOERT, CEDRIC, p. 154.

[38] See *Ibid.,* p. 38.

territory, including the concept of control over events that affect that territory. The extension of this notion separated the subjective theory of territorial jurisdiction from the objective, the latter embracing constituent effects.[39] Furthermore, the Lotus case emphasized the distinction between prescriptive and enforcement jurisdiction.[40] International law would permit jurisdiction to prescribe rules extraterritorially, but it would not allow its extraterritorial enforcement. Following this line of thought, it's correct to affirm that territorial sovereignty, in its traditional perspective, is directly linked with enforcement jurisdiction, but not with prescriptive.

1.1.2. US's contribution

1.1.2.1. Effects' doctrine

The effects doctrine, first denoted in the Lotus case in 1927,[41] and enacted by the Supreme Court of the United States in the Alcoa case in 1945, can also be of assistance to accentuate jurisdiction's limits. This last case asserted United States' power to apply its jurisdiction over foreign antitrust violations, provided that these have direct, substantial and reasonably foreseeable domestic effects.[42] This policy is applied when none of the constituting elements of the facts have taken place inside the State, still, the effects of facts occurred outside its borders, are felt within the State.[43] Notwithstanding, there are authors who argue that jurisdiction will only be defendable if a constituent element of an act forbidden by law has occurred within a State's territory, ensuing an analogy with criminal law. Akehurst argues that there are no substantial grounds to sustain the limitation, which would lead to breaches in the law.[44] A set of facts may have effects on a different number of states, therefore it is imperative to classify effects as primary or secondary.[45]

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[39] See MEESSEN, KARL, *Drafting Rules on Extraterritorial Jurisdiction,* p. 228 *in* Extraterritorial jurisdiction in theory and practice (Meessen, Karl M. ed., London: Kluwer Law International. 1996); Maier, Harold G., p. 66.

[40] See RYNGOERT, CEDRIC, p. 35.

[41] See MAIER, HAROLD G, p. 66.

[42] See RYNGOERT, CEDRIC, p. 142.

[43] See BOWETT, D. W., *Jurisdiction: Changing Patterns of Authority over Activities and Resources*, p. 243 *in* Jurisdiction in International Law (Reisman, Michael W. ed., Ashgate. 1999).

[44] See AKEHURST, MICHAEL, *Jurisdiction in International Law*, p. 75 et seq. *in* Jurisdiction in International Law (Reisman, Michael W. ed., Ashgate. 1999).

[45] See *Ibid.,* p. 78 and 81.

The controversy of such doctrine is clear, as some states regard it as an overreach of jurisdiction.[46] Additionally, the application of the effects doctrine, which is traditionally associated to criminal law, in the field of economic law, for example in antitrust matters, raises reservations.[47] The statement from the case US v. Aluminum Co. of America perfectly explains the doctrine, "Any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends." Although the effects doctrine is infamous for being applied in the United States, it has been mentioned in antitrust European cases. In the Imperial Chemical Industries, Ltd. V. Commission of the European Communities, the Commission argued that jurisdiction based on effects was in accordance with international law.[48]

1.1.2.2. Other States' interests

The obligation of considering Member States' concurrent interests, introduced by American judgments as Timberlane Lumber Co. v. Bank of America[49] and Mannington Mills v. Congoleum Corporation, is not inherent to customary international law, at most, comity or courtesy are applied. Even US courts modified their view on the balancing of interests, in the case Laker Airways v. Sabena, the court stated that the reconciliation of conflicting interests was to be solved by diplomatic negotiations.[50] Nevertheless, the respect for other states' interests is still present in the Restatement.[51] Maan critiques the concept of interests, as he perceives the doctrine nothing but a political consideration which does not meet the requirement of objectiveness.[52] Harold G.Maier goes further and

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[46] See HIGGINS, ROSALYN, *Allocating Competence: Jurisdiction*, p. 285 *in* Jurisdiction in International Law (Reisman, Michael W. ed., Ashgate. 1999).

[47] See RYNGOERT, CEDRIC, p. 199.

[48] See AKEHURST, MICHAEL, p. 77.

[49] Available at http://sitemaker.umich.edu/drwcasebook/files/timberlane_v._bank_of_america.pdf.

[50] See SHAW, MALCOM, p. 690.

[51] See Paragrah 402 (3) certain conduct outside its territory by persons not its nationals that is directed at the security of the state or against a limited class of other states interests and Paragrah 403 (3) When it would not be unreasonable for each of two States to exercise jurisdiction over a person or activity , but the prescriptions from the two states are in conflict, each state has an obligation to evaluate its own as well as other state's interest in exercising jurisdiction, in light of all the relevant factors , including those set at Subsection (2); a state should defer to other state's if that state's interest is clearly greater.

[52] See MAAN, FREDERICK A., p. 151.

articulates the reasoning behind the scepticism of such balance: who will proceed to do it and how will it be done?[53] As it would be unreasonable for the balancing of interests to be made by the courts of one party,[54] Paul Peters suggests independent courts or arbitrators as viable candidates to enact the balancing of interests, as national courts are most possibly unreliable to make such judgment.[55] Europe is apprehensive about the concept of interest balancing since courts are not regarded as diplomats, and the discretionary power given by such method is uncharacteristic. The Wood Pulp and Gencor cases demonstrate how uncomfortable Europe is with solving extraterritorial jurisdiction matters. A notion that is more probable of being acknowledged in Europe is connection. Interests can be defined as a common concern, linked with politics or business, on the contrary, connection presupposes a link or relationship.[56]

1.1.2.3. The American Law Institution Restatement (Third) of Foreign Relations Law

Faced with several jurisdiction conflicts, with the aim of promoting clarification and simplification of law, the American Law Institute, in 1987 drafted the Restatement (Third) of Foreign Relations Law. The rule of reason is applicable to all fields of law, nevertheless, it has a deep link with antitrust cases. Section 403 of the latter combines principles of customary international law and comity to create a framework for analysing extraterritoriality cases.[57] Most authors do not recognise the restatement as a rule of customary international law, however, in order to be perceived as so, there is no necessity for appliance by all states, but a lack of objection.[58]

Maan considers the rule of reason as being too open to be enacted at an international level, nonetheless, it considers it workable. Gary Born defends the

[53] See MARTHA, RUTSEL SILVESTRE J., *Extraterritorial Taxation in International Law*, p. 85 *in* Extraterritorial jurisdiction in theory and practice (MEESSEN, KARL ed., London: Kluwer Law International. 1996).

[54] See BOWETT, D. W., p. 257.

[55] See MAIER, G. HAROLD, p. 157.

[56] See RYNGOERT, CEDRIC, p. 165 et seq.

[57] See MAIER, G. HAROLD, p. 71.

[58] See RYNGOERT, CEDRIC, p. 152 and 161.

restatement against opponents, by asserting that the rule of reason is considered too vague and ambiguous, because its evolutionary process is still enduring.[59]

The introduction by the restatement of the limit of reasonableness, is to be commended. This concept functions as a limitation to overreaches of jurisdiction.[60] Paragraph 403 (1) introduces the notion, even when one of the basis for jurisdiction under § 402 is fulfilled, that a state may not exercise jurisdiction to prescribe law, with respect to a person or activity having connections with another state, when the exercise of such jurisdiction is unreasonable. This requisite is only identified by analysing each case individually, still, paragraph 403 (2) indicates a non-exclusive list of aspects which may influence the interpretative process. The respect imposed by the fulfilment of this notion mirrors the comity principle.[61]

The balancing obligation present in the Restatement, is not a new concept on international law, equity follows the same line of thought.[62] Notwithstanding that a rule of reason has not been explicitly adopted by Europe, in the Eastern Aluminium case, a reasonableness criteria is to, some extent, utilized.[63]

1.1.3. Protective principle

Another basis for extraterritorial jurisdiction is the protective principle. Despite the fact that this principle is mainly applied in criminal law, the extension of it to other areas of law is in debate.[64] The referred principle allows states to exercise jurisdiction over subjects who have committed an act abroad, which is deemed to be prejudicial to its territory. Extraterritorial jurisdiction is, consequently, admissible to protect states' interests.[65] This principle needs to be limited, similarly to the effects doctrine, solely primary effects should be considered.[66]

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[59] See MEESSEN, KARL, *Drafting Rules on Extraterritorial Jurisdiction,* p. 247.

[60] See RYNGOERT, CEDRIC, p. 153.

[61] See MAIER, G. HAROLD, p. 72.

[62] See RYNGOERT, CEDRIC, p. 156.

[63] See *ibid.,* p. 171.

[64] See BOWETT, D. W., p. 246.

[65] See SHAW, MALCOM, p. 667.

[66] See AKEHURST, MICHAEL, p. 39.

1.1.4. Concept of substantial and genuine connection

A truly demanding undertaking is to formulate a principle which outlines the extent of a State's jurisdiction.[67] Such model has to be capable of achieving a balance between certainty and adaptability.[68] This challenging task raises uncertainties concerning extraterritoriality,[69] and the legitimacy of the territoriality principle as the foundation of jurisdiction. There is no unanimity on how to define jurisdiction's limits, still, currently, the fundamental question placed forward by authors is "if a sufficiently close connection is present between a given set of facts and a particular legal system". Consequently, an assessment of reasonableness is required, with the weighing of legally significant elements, disregarding economic, social and political interests.[70] Indeed, in recent years authors have stepped away from the notion of territoriality and moved closer to the idea of connection and reasonableness, which is presently the foundation of contemporary International Law,[71] The levy of taxes outside the territory of a state has been accepted in customary international law, as long as there is a genuine connection between the State and the taxpayer, transaction or property.[72] An association between the state and the fiscal subject or object of taxation is obligatory, determining the legality of fiscal jurisdiction.[73]

The significant connection doctrine does not exclude the existence of concurrent claims, the applicable standards, collected from state practice, will determine which of the claims has a stronger connection. This method differs from the balancing of interests concept, as state practice is a more reliable and objective source.[74]

Germany's Federal Constitutional Court embraced the substantial and genuine

[67] See MAAN, FREDERICK A., p. 146.

[68] See MAIER, HAROLD G., p. 89.

[69] See HIGGINS, ROSALYN, p. 283.

[70] See MAAN, FREDERICK A., p. 148.

[71] See HALPERN, JOSEPH, "*Exorbitant Jurisdiction" and the Brussels Convention: Toward a Theory of Restraint*, p. 478 et seq. *in* Extraterritorial jurisdiction in theory and practice (Meessen, Karl ed., London: Kluwer Law International. 1996); MAIER, HAROLD G., p. 90.

[72] See SHAW, MALCOM, p. 650 and AKEHURST, MICHAEL, p. 59.

[73] See MARTHA, RUTSEL SILVESTRE J., p. 23.

[74] See *ibid.,* p. 91.

link doctrine, when it recognized the right for a State to tax depends on the existence of a reasonable link between the State and the person, property or transaction.[75]

1.2. Extraterritorial Jurisdiction

Extraterritorial jurisdiction, regulates matters which do not have a territorial link with the State who claims to have authority. However, in most cases of extraterritorial jurisdiction, some form of territorial link is present, even if not exclusive.[76] The prospect of a state exercising prerogatives over facts or subjects outside its borders is, ironically, connected to the territoriality principle. In a time when physical borders slowly become irrelevant, an updated viewpoint of territory, and its ramifications, is imperative. What is desired is a characterisation of territorial jurisdiction closer to reality, and not the defence of unrestrained sovereignty.

The foremost difficulty with extraterritoriality, is the lack of consensus on how to resolve the overlapping of concurrent jurisdictional claims. There is no recognized universal rule of conventional or customary international law distinct delimitation, and fragmentation of jurisdiction law is detrimental.[77] Extraterritorial taxation problems are, occasionally, solved by double taxation treaties. Nevertheless, the absence of positive public international law governing jurisdiction to tax, contributes to the escalation of jurisdictional conflicts.[78] In addition to criminal and antitrust matters, securities law is another field in which extraterritorial difficulties ensue.[79]

1.3. Chapter's conclusions

This chapter scrutinized the fundamentals entailed to comprehend territoriality in the proposed directive, which will be contemplated in the succeeding pages. Prior to analysing the territorial issues raised by the FTT, it was imperative to refer to the jurisdiction to tax, and its territorial boundaries. As I have highlighted previously, there is no consensus on the delineation of territorial jurisdictions' boundaries. The inexistence

[75] See MAAN, FREDERICK A., p. 149; CHRISTIAN TIEJ, JURGEN BERING AND TOBIAS ZUBER, Und Europarechliche Zulassigkeit Extraterntorialer Anknupfung einer Finanztransaktionsseuer, (Heft 129. 2014) p. 8; Case BverfGE 63 343 (369).

[76] See RYNGOERT, CEDRIC, p. 20.

[77] See MAIER, HAROLD G., p. 100.

[78] See *ibid.,* p. 20 et seq.

[79] See RYNGOERT, CEDRIC, p. 327.

of a centralized international legal system fuels, even further, the issue in question. There are some internationally recognized principles, as the protective and non-intervention, which contribute to the paradigm, still, they are not sufficient to successfully resolve the territorial concerns. For that reason, a panoply of doctrines were created in order to respond to the problem. The Classical International Law Doctrine was challenged by the infamous Lotus Case, which acknowledged a less restrict notion of tax jurisdiction. The United States of America are notorious for its overstretched model of prerogatives, consequently, it is expected that an abundant amount of progresses should follow, in this territorial matter, with origins in that country. Although the European Union does not explicitly acknowledge those doctrines, they contribute to the enrichment of the debate, and may be employed as the basis for a solution. The existence of a substantial and genuine connection is appointed as the most adequate doctrine to resolve the dispute of Jurisdiction's territory boundaries.

CHAPTER 2

Territoriality

The proposed directive has been looked upon with scepticism, and controversy regarding the legality of its territorial scope and its administrative feasibility has arisen. The matter of disagreement is its overreach of jurisdiction enabled by the tax triggering factors. The previous chapter elected the genuine connection as the best criterion to legitimate tax jurisdiction. With that paradigm in mind, this chapter aims to reflect upon the territoriality of FTT in four distinct perspectives with the objective of substantiating the legality of the proposal and practical viability.

Specifically, in order to achieve an adequate legal and practical analysis it is imperative to further understand the proposed directive in two other perspectives. The rationale behind including a structural and economic perspective is to achieve a full comprehension of the background and the motives behind the design of the proposed tax. Subsequent to grasping how the tax works, and why those policy options were made, the focus turns to the legality of those choices, considered in the legal perspective. Finally, the practical perspective aims at understanding the administrative achievability of a tax with such an extensive territorial scope.

2.2. Structural Perspective

The success of a tax on financial transactions relies upon the decision of which factor should trigger the taxable event.[80] The 2011 proposal was centred in the application of a broadly-defined residence principle associated with the taxation of the counterparty to the transaction. The original proposal, which was already sensible to the phenomenon of relocation, was altered after the number of participating Member States was reduced. This policy can be by justified by the necessity to contradict tax avoidance, the lower the number of countries which implement the tax, the higher is the risk of substitution behaviour and relocation of activities. Complementing the connecting factor of residence

[80] See LENDVAI, JULIA, RACIBORSKI, RAFAL AND VOGEL, LUKAS, *Macroeconomic Impact of Financial Transaction Taxes*, p. 198 *in* Taxation and Regulation of the Financial Sector (Ruud de Mooij and Gaëtan Nicodème eds., CESifo seminar series. 2014).

with the issuance principle was regarded as a reinforcement of the primary proposal.[81]

2.1.1. The residence and counterparty principle

According to the residence principle, once a territorial link is found between the financial institution part of the transaction and a participating member-state, that institution is deemed to be established in the latter, and as a result is liable to pay FTT. Daniel Shaviro regards the use of residence as the basis of the FTT, rather than source-based jurisdiction, as one of its strongest features.[82] The list of conditions present in Article 4 (1) is hierarchical. If more than one condition is fulfilled, the first condition met is the relevant one for determining establishment. Oskar Henkow argues that the authorization, registered seat and branches connecting factors are easily detectable. The authorization and seat settings, do not necessarily, correctly, reflect where the activity of the institution is primarily carried out, manipulation of those connecting factors is possible. The third connecting factor refers to the permanent address or usual residence which has to be understood as the domicile of the company, when it does not coincide with the registered seat.[83]

The last connecting factor is the counterparty principle, which goes further than any other. The other part of the financial transaction, if not deemed to be established within the FTT-Zone, neither by the residence or the issuance principle, will be deemed to be established in the same participating member-state as the part which has been deemed established.[84] As a consequence of the application of this principle, the other part of the transaction will be taxed in the same conditions as the part which has been established in the FTT-zone. The key concept in discussion is “sufficient link”. The legality of the counterparty principle will be examined later in this study, in the legal perspective sector.

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[81] See EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax,* p. 5; EUROPEAN COMMISSION, *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts,* p. 40 and 43.

[82] See SHAVIRO, DANIEL, *The Financial Transactions Tax vs the Financial Activities Tax*, p. 172 *in* Taxing the Financial Sector Financial taxes, Bank Levies and more (Marres, Otto and Weber, Dennis eds., IBFD. 2012).

[83] See HENKOW, OSKAR, p. 15.

[84] See Article 4 (1) (f)) of the Proposed Directive.

Figure 1 demonstrates the functioning of the counterparty principle and its consequences.

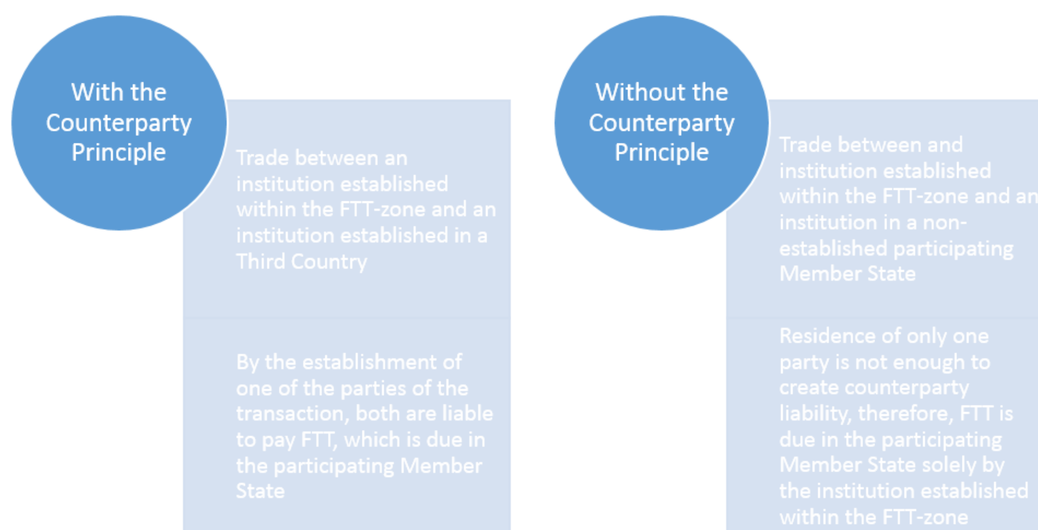

Figure 1. The Functioning of the Counterparty Principle

2.1.2. The issuance principle

The issuance principle can be applied in different manners, in other words, with different connecting factors. For securities and similar instruments (denominated in the directive, as "financial instruments", which include transferable securities, money-market instruments, and units in collective investment undertakings),[85] the definition of issuance is straightforward: as mentioned in the directive, a financial instrument issued within the territory of a participating Member State means "such financial instrument that is issued by a person who has its registered seat or, in case of a natural person, its permanent address or, if no permanent address can be ascertained, its usual residence in that State;".[86] Financial instruments always have a substantial link with their issuing State, consequently, no objections to the legality of this principle are expected.[87] For derivatives, one of the options is establishing as connecting factor the legal seat of the issuer of the underlying security. A second option, which has been adopted by the proposal,[88] is according to the place of transaction, this option only includes instruments

[85] See Article 2 n1 (11) and Section C of annex I of directive 2004/39/EC.

[86] See Article 2 n1 (11) from the proposed Directive.

[87] See TIETJE, BERING AND ZUBER, VOLKER, p. 24.

[88] See Article 4 (1) (g) of the Proposed Directive.

which are traded on an organised platform. Both alternatives possess weak spots, the first can raise legal issues, if one believes there is not a sufficient nexus for the taxation of derivatives. The second leaves untouched all instruments which are not negotiated in an organized platform, for instance over the counter derivatives. In order to understand the functioning of this principle an example is described. A transaction between a non-participating Member State and a Third Country involving shares issued by a Portuguese company, or other company established within the FTT-zone, tax is due in Portugal.

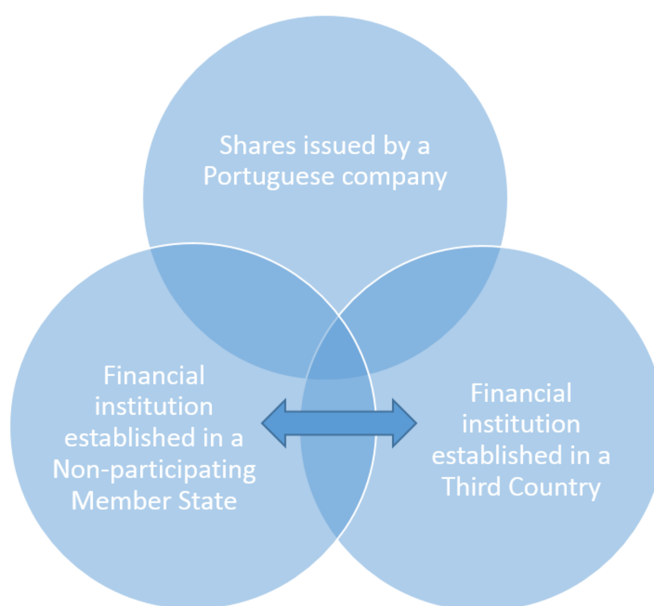

Figure 2. Issuance Principle Example

2.1.4. Cumulative application of principles

The proposal put forward by the commission establishes a cumulative application of both the residence and the issuance principles. In such way that, if no counterparty is deemed to be established in the FTT-Zone, but shares issued in that zone are bought/sold/exchanged, they will be subject of taxation.

The proposed directive can be characterised as broad-based. Its wide scope is felt on the financial institutions it covers (actors), on the financial instruments which are potentially taxed and in the establishment of tax jurisdiction. The latter issue has been the key focus of the proposal. Tax jurisdiction is, and will most likely always be, a sensitive matter. Non-participating Member-States and Third countries are deeply concerned about the effects of the implementation of an FTT on their jurisdictions, namely on its possibility of having an "extraterritorial effect".

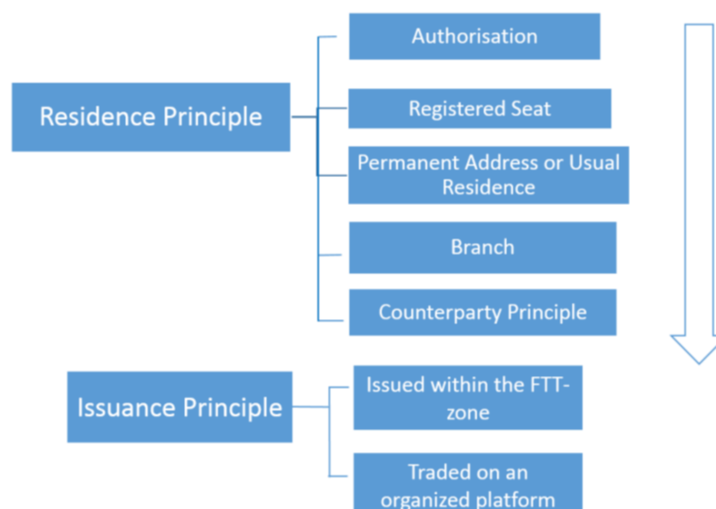

Figure 3. Hierarchy of tax triggering principles and factors

2.2. Economic Perspective

2.2.1. Substitution behaviour and relocation

The introduction of a financial transaction tax increases the cost of each transaction. Investors may adopt one of four conducts: continue trading and pay the tax, change the location of the trade, trade non-taxed financial instruments or don't trade at all.[89] The financial sector is characterized by its extraordinary capability of innovation and mobility.[90] Tax avoidance and tax planning prospects must be taken into account in the design of any tax, particularly one which targets such an elusive sector. Consequently, FTT was conceived with the hazard of substitution behaviour in mind. Being able to prevent this conduct will assure the success of the tax, and guarantee its purposes are reached. Substitution may occur concerning actors, for instance with the utilization of financial institutions outside the scope of the tax, or regarding financial instruments, by choosing to trade untaxed assets. Furthermore, substitution behaviour may materialize in cross-border migration of trade, otherwise acknowledged as delocalization. Tax design was essential to avert the occurrence of geographical relocation of transactions in the proposed tax, undermining its enactment.

[89] See SCHULMEISTER, ET AL, p. 23.

[90] See EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax*, p. 2.

2.2.1.1. Tax rates

The idea behind the FTT is that very low tax rates will not incentive relocation,[91] still, this measure would have not been enough to prevent such occurrence. Once it became clear that a financial tax at a European level was unattainable, amendments had to be made to the 2011's proposal. With the partaking of fewer Member-States, and geographical coverage being narrower, replacement conducts proliferate, therefore justifying the introduction of the issuance principle.[92] The impact assessment states that the introduction of such principle will aid at combating evasion and relocation by widening the scope of the tax by 10%.[93] This addition, allied with very low tax rates, a broad-scope, the anti-abuse clause and the residence principle contribute to the design of a relocation-proof tax. The tax can merely be evaded by financial organizations which no longer wish to operate in the EU market.[94] The risk of operations shifting is minor, since taxation relies upon the identity of the parties and characterization of the tradable assets, not on where the transaction takes place.[95]

The impact assessment advocates the enactment of standard rates instead of minimum rates to avoid tax planning opportunities amongst the participating member-states.[96] Another proposed measure to combat relocation is the use of differentiated tax rates, according to products' mobility. Nevertheless, some authors note that this approach may rise collection costs, reduce revenues and possibly produce distortions between the different products.[97]

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[91] See HEMMELGARN, T., AND NICODEME, G., *The 2008 Financial Crisis and Taxation Policy*, Centre Emile Bernheim, Working Paper No. 10/006 (2010) p. 145.

[92] See EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax*, p. 5; EUROPEAN COMMISSION, *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts,* p. 18.

[93] See *ibid.,* p. 40.

[94] See *ibid.,* p. 4.

[95] See EUROPEAN COMMISSION, FTT Non-technical Answers to Some Questions on Core Features and Potential Effects, p. 6.

[96] See EUROPEAN COMMISSION, *Implementing enhanced cooperation in the area of financial transaction tax*, p. 5; European Commission, *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts*, p. 17.

[97] See HEMMELGARN, THOMAS ET AL, p. 146.

2.2.1.2 Broad-based tax

The design of a broad-based tax constitutes another adequate approach in combating tax avoidance. The proposed tax addresses an extensive list of actors, markets and financial instruments. The inclusion of derivatives in the scope of the tax is to be commended. These opaque instruments are extensively perceived as having helped generate the financial crisis, as they allow taxpayers to increase the separation between their economic fundaments, and the tax system's interpretation of their actions. Tax treatment asymmetry, inconsistency and imbalance, follow as the result of derivatives and tax opportunities provided by these instruments must be taken into account.[98] If the residence principle is applied to all shares, national and foreign, provided they are traded by at least one resident institution, then all derivatives on shares, independently of whether or not the underlying shares are national or foreign, should also be taxed. It is a matter of equality and symmetry in tax policy.

2.3. Legal Perspective

2.3.1. The Council's legal service opinion[99]

Besides the disapproval from non-participating Member States and Third Countries, the legal services of the council has made public a document expressing their doubts regarding the extended territorial scope of the FTT.

According to the document in question, Article 4 (1) (f) of the proposed directive, imposing FTT on financial institutions resident in non-participating Member States (counterparty principle), surpasses jurisdiction for taxation under international customary law.[100] The legal services identify the necessity of a relevant link between the State which exercises jurisdiction, and the person or situation over which jurisdiction is exercised. This link needs to be validated by pertinent policy objectives. For that matter, the revenue-raising aim of an FTT, is not considered strong enough to corroborate a remote nexus for taxation. Likewise, the need for the financial sector to subsidize the costs of the crisis, in the opinion of the legal services, does not justify such connection. The tax will target

[98] See *ibid.,* p. 184.

[99] See COUNCIL OF THE EUROPEAN UNION, *Opinion of the legal service, Proposal for a Council Directive Implementing Enhanced cooperation in the Area of Financial Transaction Tax, Legality of the Counterparty-based Deemed Establishment of Financial Institutions* (2013).

[100] See Article 3 (5) TEU.

financial institutions and instruments which have not contributed to the development of the crisis, and if they had contributed, revenues collected from taxation, would be entitled to the States where they are established. The proposed tax will affect not only risky activities, but also activities which do not generate systemic risk. Therefore such objective cannot, also, substantiate the legitimacy of a distant connection.[101] Lastly, the counterparty principle may not be justified by being an anti-fraud or anti-evasion measure, as it does not comply with the proportionality principle.[102]

The counterparty principle is characterized as being discriminatory. As a result of its functioning, participating Member States will not only tax their own financial institutions, but also financial institutions established in Non-participating Member States and Third Countries. The same will not occur if a transaction takes places between two Participating Member States. The legal services state that, the two situations described are identical from a territorial point of view, though are treated differently, solely, because a State did not agree to participate in enhanced cooperation.[103] Moreover, double taxation is avoided within the FTT-zone, but there is no double tax relief for non-participating Member States and Third Countries, which will have to deal with higher costs. As a result of the counterparty principle, financial institutions established outside the FTT-zone will be submitted to 11 different tax rates, depending of who they are contracting with.[104] Additionally discriminatory, according to the legal services, is the fact that joint liability is less likely to occur, when two financial institutions established in the FTT-zone contract, then when the counterparty is a financial institution which is not established in the FTT-zone. Participating Member States entitled to the tax, are unlikely to be unable to enforce payment on an institution established in their own territory. These premises are likely to influence capital movements.[105]

The recovery of taxes from financial institutions established in non-participating Member States is easier, due to the obligation of providing mutual assistance, than from financial institutions established in Third-countries. This, can result in distortions of

[101] See COUNCIL OF THE EUROPEAN UNION, *Opinion of the legal service, Proposal for a Council Directive Implementing Enhanced cooperation in the Area of Financial Transaction Tax, Legality of the Counterparty-based Deemed Establishment of Financial Institutions*, p. 7.

[102] See *ibid.,* p. 8.

[103] See *ibid.,* p. 9.

[104] See *ibid.,* p. 10.

[105] See *ibid.,* p. 11.

competition and capital movement.[106] The latter freedom is also considered, by the legal services of the council, to be under restriction as a consequence of FTT. The Counterparty principle makes financial transactions with financial institutions located outside the participating Member States less attractive, as these financial institutions are subjected to 11 different tax rates, which generates legal uncertainty, and due to joint liability, which may cause disputes with tax authorities.[107]

Article 4 (1) (g) is critiqued by the Legal Services for, once again, being regarded as extraterritorial, exceeding the Union's legislative jurisdiction. The Wood Pulp case is referred at this point, the automatic character of the issuance principle does not permit an individual analysis of cases. The critique is extended to the substance over form clause present at Article 4 (3). This escape clause is regarded as unsatisfactory.[108]

Article 327 TFEU, the basis of enhanced cooperation, states that enhanced cooperation should respect the competences, rights and obligations of member states who choose not to partake. Defending non-participating States' option to adopt their own tax systems.[109] The Legal Services of the Council, regard the fact that FTT will still burden Member States who choose not to participate a violation of Article 327 TFEU. Even with double taxation relief, non-participating Member States will still contribute to the budget of participating Member States, while the contrary will not happen.[110]

2.3.2. Non-paper by the Commission Services[111]

The Commissions services released a response to the document analysed previously, emphasizing the legality of the proposal.

The Commission services agrees with the statement that customary international law must be complied with, the treaties dispositions must be respected and all points of

[106] See Article 56 to 66 TFEU.

[107] See COUNCIL OF THE EUROPEAN UNION, *Opinion of the legal service, Proposal for a Council Directive Implementing Enhanced cooperation in the Area of Financial Transaction Tax, Legality of the Counterparty-based Deemed Establishment of Financial Institutions*, p. 13.

[108] See *ibid.*, p. 8.

[109] See *ibid.,* p. 11.

[110] See *ibid.,* p. 12.

[111] See EUROPEAN COMMISSION, *Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Response to the Opinion of the Legal Service of the Council on the Legality of the Counterparty-based Deemed Establishment of Financial Institutions*, *Non-paper by the Commission Services* (2013).

article 327 TFEU must be fulfilled in order for enhanced cooperation to be applied. Nevertheless, the arguments put forward by the Legal Services of the Council are unfounded and inapplicable.[112]

When establishing tax jurisdiction one may rely on two principles - nationality (personality) and territoriality. Territoriality, also includes events that, even by not taking place inside the territory of a Member-State, will still have an effect on it. When establishing if there is a territorial connection, the Council Legal Services asks the wrong question "Do other states have a more relevant interest in regulating the taxpayer's conduct then the Participating Member-State?”. Indeed, the right question is: "is there sufficient nexus to justify the exercise of taxing jurisdiction by the Participating Member-State?”. It appears there is a misunderstanding between "nexus", and the interests of other states.[113] The American Law Institute does not consider interest as a requirement of international law. A clear example is that on paragraph 403 the word may is used: "a state may not exercise jurisdiction to prescribe law with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable". Therefore other States' interests are merely taken into consideration in an ambience of mutual courtesy and respect between nations. Even though another States' interest are not, a valid limitation to tax jurisdiction, it does not signify that there are no limitations. The right criteria is the connection.[114] Fiscal attachment may be personal or economic. Examples of personal connection factors are domicile, residence or citizenship of individuals, and the place of incorporation or of effective management of legal entities. On the other hand, an economic attachment is born when a transaction or activity is connected to the territory of a State.[115] A good example of the latter is placed forward by paragraph 402 (4) " 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 ore presence of the parties to such a transaction". This paragraph provides legal grounds for the counterparty principle. Furthermore, as stated by the Commissions’ legal services, the counterparty principle only applies if there is an actual connecting factor, in other words, if the counterparty is

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[112] See *ibid.,* p. 3.

[113] See *ibid.,* p. 4.

[114] See *ibid.,* p. 5.

[115] See *ibid.,* p. 6.

deemed to be established in a participating Member State. Only if one of the situations described by article 4 (1) (a) to (e) is fulfilled.[116] Certainly, in all cross-border financial transactions there is a connection between the non-participating Member State or third country, with the participating Member-state. By negotiating with the participating Member-State an economic attachment is established, placing the non-participating Member-State or third country under its tax jurisdiction. A great example of the imposition of tax jurisdiction is, in fact, the UK's stamp duty, as it applies to the transfer of shares linked to the UK, even if the parties of the transaction are both resident outside the UK.[117] Besides, the proposed directive answers the concerns of an insufficient nexus by the inclusion of an escape clause, making it clear that the proposed directive does not intend to disrespect other Member States' jurisdiction. It is therefore incomprehensive, in the opinion of the services of the commission, the criticism to Article 4 (3).[118] The services of the commission believe the legal services of the Council have a restricted, and incorrect concept of territoriality, which is shown by the reference to the Wood Pulp case and by assertions regarding the greater interest of other States.

The Commission's services, likewise, state that all requisites of the application of enhanced corporation are fulfilled. The Non-participant Member-State's liberty to create and maintain taxes on financial transactions remains untouched. Furthermore, concerning double taxation, it will occur if Non-Participating Member States have an FTT of their own. Still, that is not a reason to discredit the adoption of a harmonized FTT, on the contrary, it should be viewed as a reason for its implementation. Then again, double taxation is not banned within the European Union, and is a recurring problem, the standard solutions should be applied. Customary International Law does not avert the intersection of different national tax jurisdictions.[119] Furthermore, the Commissions services emphasize that "The tax does not create a burden for the financial markets of the non-participating Member States, but only for the activities of the financial institutions affecting the market of the participating Member State.".[120]

The Council's Legal Services is alarmed about Article 4 (1) (f) only applying to financial institutions which are not established in participating member states, qualifying

[116] See *ibid.,* p. 8.

[117] See *ibid.,* p. 9.

[118] See *ibid.,* p. 10.

[119] See *ibid.,* p. 13.

[120] See *ibid.,* p. 14

the article in question as a discrimination or as a barrier to the free movement of capital or the freedom to provide services. In the Commission's opinion there is in both situations two FTT claims, the fact that there is a mechanism for the allocation of taxing rights between participating Member-States cannot be considered a discriminating measure. Moreover, the fact that non-participating Member-States and third countries may be subjected to 11 different rates cannot, likewise, be viewed as discriminatory. Once again, this is a recurring problem within the European Union, which is present for example in the VAT Directive.[121] Regarding the enforcement of payment, it has been recognized by the CJEU the difficulty of collecting taxes in cross-border situations and the high risk it evolves, consequently joint liability cannot be perceived as a discriminatory measure. If it is so, then again, so it would be the case with Articles 193 to 205 of the VAT Directive.

The allegations of distortion of competition are quickly placed aside by the Commissions' services, by reminding the Council Legal Services that the alleged distortions are outside the scope of Article 326 TFEU.[122] The argument that the implementation of an FTT may create an obstacle to the free movement of capital, has to be answered with a detailed analysis, which is not done by the Commissions' services. The services simply state that any tax on cross-border activity cannot, automatically, be considered an obstacle.[123]

2.3.3. Further premises in support of the proposed Directive: Critical analysis.

The financial sector and its trading activity, unsurprisingly cause effects which transverse various states. Accordingly, extraterritorial jurisdiction in this field can derive from a loosely assembled territoriality principle. The territorial Principle, perceived as the foundation of sovereignty, has adapted itself to accommodate to the existence of mobile things like ships and aircrafts.[124] My question is, why can't it adjust to the existence of cross-border transactions? Furthermore, the acceptance of unitary taxation contributes to the affirmation of legality of a tax on financial transactions.

[121] See *ibid.,* p. 16.

[122] See *ibid.,* p. 17.

[123] See *ibid.,* p. 18.

[124] See BOWETT, D. W., p. 240.

2.3.3.1. Customary International Law

Customary International law, and general principles of law, are a primary source for international tax law, which deals with tax conflicts concerning cross-border transactions. There are two doctrines on jurisdiction to tax, one believes in no limitations to the State's right to tax, while the other argues that jurisdiction to tax is restricted by territory. The two schools of thought have different perceptions of State sovereignty. Although a consensus is not reached on the existence or non-existence of restrictions, there is consensus on the relevance of connecting factors. One of the recognized connecting factors is the existence of an economic attachment, due to the development of an economic activity. An entity, though not resident, is present in the taxing country in some meaningful way.[125]

The FTT's counterparty principle's legality is the centre of the controversy, as it is understood, by some, as having an extraterritorial effect, inconsistent with international law. International customary law, as established before, sets the limit of relevant or sufficient link. This limit is considered, by opponents of the tax, to be disrespected by the FTT. The mentioned doctrine does not consist of a strict rule, as the globalised and interdependent economy requires a certain amount of adaptability and ambiguity. Consequently, an interpretative case-by-case analysis is obligatory in order to establish the existence, or non-existence, of a significant connection. The Article in question requires a territorial connection with the FTT-zone, as it is only applicable if one of the parties of the transaction is deemed to be established in a participating Member State. The true question is if being in a transaction with a participating Member-State is sufficient to acknowledge a genuine connection with the taxing state. In my view, it is. The establishment of a part of the transaction within the FTT-zone, attributes jurisdiction concerning the whole transaction. The two parties and the transaction constitute one fact, taxable by the participating Member State. In tax law, especially when dealing with cross-border transactions, an economic affiliation is enough to justify the right to tax. Further, it should not be forgotten that legislative jurisdiction, as established in chapter 1, is competitive by nature, and not exclusive.[126] In addition, other methods which designate States' jurisdiction, described in Chapter 1, can be employed to corroborate the legality of the provision.

[125] See ROHATGI, ROY, p. 11 et seq.

[126] See TIETJE/BERING/ZUBER p. 21 and 22.

In particular, the American Law Institute's Restatement (Third) of Foreign Relations Law of the United States, introduces the view that a state may exercise jurisdiction based on two criteria: either a personal or territorial link between the entity and the transaction exists, or there is an economic connection, in the sense that a transaction affects the territory of the State, justifying the exercise of jurisdiction. The latter method of establishing jurisdiction, likewise, corroborates the legality of the counterparty principle. The 2008 deep economic crisis, uncovered the consequences of under taxed and unregulated financial markets. FTT's proposed Directive was assembled with the aim, amongst others, of correcting markets' behaviour. These objectives are accomplished by the tax treatment of transactions. Transactions which fall within the scope of this directive have, besides a territorial connection, an economic link with the participating Member State claiming jurisdiction, as their effects, positive or negative, will be felt, not exclusively but nonetheless, within its borders.

The protective principle is an acknowledged norm of international law. It recognizes the possibility of a State to assert authority over events even though they do not take place within its territorial scope. The intervention of the State must be justified by a domestic interest deserving protection and is required to be reasonable. Even though this principle is traditionally mainly used in criminal law, the ECJ has been applying it to anti-trust law, with the purpose of protecting the internal market.[127] Notwithstanding I do not consider the counterparty principle to entail an extraterritorial measure, if it did, the referred principle would easily be applicable. The correction of market's entities toxic behaviour and subsequently reaching an equilibrium of the financial sector, are eligible domestic interests deserving protection.[128] The 2008 crisis exemplified remarkably the importance of having a healthy financial sector to the general world economy. I agree with Higgins, on the necessity of adopting a flexible approach to solving jurisdiction matters, especially when the protection of common values, like the stabilization of financial markets, is in question.[129]

2.3.3.2. Distortion and Proportionality

Proportionality of the measure, when compared to its objectives, is placed in

[127] See Wood Pulp and Ahlstrom case.

[128] See TIETJE/BERING/ZUBER p. 28 and 29.

[129] See HIGGINS, ROSALYN, p. 288.

question by FTT's antagonists. The principle of proportionality requires a measure to be of an adequate size or degree to the objective it is pursuing.[130] Besides curbing excessive financial market volatility, stabilizing markets and raising revenues, coordinated action in this matter contributes to European integration, therefore, assertion of disproportionality is unfounded.

Moreover, the claim of Article's 327 TFEU violation is likewise unsubstantiated. Non-participating Member States are still able to maintain or adopt their own taxes targeting the financial market. The existence of an overlap is a common phenomenon in the European Union as full integration is not yet accomplished. Double taxation agreements should, in principle, be sufficient to resolve such occurrence.

2.3.3.3. Free Movement of Capital

An FTT is to be enacted in the European capital markets, therefore, it is imperative to comprehend if it will have a negative impact in the European free movement of capital, or in other freedoms. When analysing an incompatibility with the four fundamental freedoms there are four steps that should be taken. The court's test comes down to fundamentally the following rule of reason assessment: does the tax measure concerned differentiate between cross-border situation and the analogous domestic situation jeopardizing the exercise of free movement? If so, is that defensible by a valid purpose? If so, does the obstructing effect not go beyond what is required to reach that reasonable aim?[131]

The first step is to identify which of the four fundamental freedoms might be affected. Is the FTT within the scope of the free movement of capital or/and the free movement of services? There is no consensus on the definition of capital movement. The CJEU resolves this problem with a causality method. For each case, the link between the two freedoms and the contested tax measure must be analysed, in order to understand which of the freedoms is directly impacted by the proposed measure. In this case I believe the freedom of providing services is only impacted secondarily, hence the FTT should fall under the scope of the free movement of capital.[132]

The second step, on the followed approach, is to understand if the tax measure

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[130] See RYNGOERT, CEDRIC, p. 157.

[131] See J.M. BEN AND WATTEL, TERRA PETER J., European tax law (Kluwer. 2012) p. 45.

[132] See *ibid.,* p. 126 et seq.

constitutes a restriction, discriminatory or non-discriminatory. The allocation of fiscal jurisdiction does not allow Member States to apply measures contrary to the fundamental freedoms.[133] In the present case, is there a discrimination or a restriction? The distinction is not always very clear. According to João Nogueira Pinto Félix discrimination invokes the idea of equality, it compares two situations which are equal in all aspects except for one. On the other hand, there is no need for the comparability test in a restriction.[134] A discriminatory measure presupposes transnational investment is treated less favourably than a parallel domestic investment. A restriction thus exists if the tax simply dissuades transnational trade. The FTT cannot be considered a discriminatory tax, contrary to what opponents believe, as it is applied to all financial institutions, established in a Member State and their counter-party. There is no distinction made between the transactions which occur domestically and transnationally. It can, hence, be concluded that the tax is not discriminatory.[135] By exempting spot currency transactions, the FTT has left untouched the free movement of capital. Even though the proposed directive cannot be understood as discriminatory, can it be considered restrictive? There are authors that consider the implementation of an FTT a restriction to high-volume and low-margin transactions.[136] My view is that, while an FTT will influence markets participants' behaviour, it cannot be perceived as a restriction. The additional costs an FTT implicates are present in the implementation of any tax, if one considers the proposed directive as restrictive, shouldn't all taxes which aim at correcting economic behaviour be also perceived as such? Still, if the tax in question is considered restrictive, it will, nevertheless, be reasonably defensible.

According to established case law, a measure which is apt to limit the freedom of establishment is allowable. Nevertheless, it has to pursue a legitimate objective, be compatible with the Treaty, and be justifiable by overruling reasons of public interest. This is the third step in the courts' judgment, known as the "rule of reason". Concerning the free movement of capital, the written justification grounds are found in Article 65 (1) (b) of TFEU. The question is if the FTT involves a fundamental interest of society and therefore can be justified by the article in question. If one considers it does not, then there

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[133] See de Groot, paragraph 94; Renneberg, paragraphs 50 and 51; and Beker, paragraphs 33 and 34.

[134] See NOGUEIRA, JOÃO FÉLIX PINTO, Direito fiscal Europeu: o Paradigma da Proporcionalidade: a Proporcionalidade como Critério Central da Compatibilidade de Normas Tributárias Internas com as Liberdades Fundamentais, (Coimbra Editora. 2010) p. 225.

[135] See *ibid.,* p. 131.

[136] See *ibid.,* p. 135.

is still the possible application of the rule of reason. In my perspective, the purpose of preventing future financial crisis by the correction of financial markets behaviour is a reasonable objective. Within this last step there are three sub-steps, its application must be suitable to guarantee the accomplishment of the objective thus pursued, and not go past what is necessary to attain it.[137] Alternative measures were available to correct market's conducts, however, it is not up to the CJEU to decide which measure is better well-suited. The court may merely decide if the FTT is a suitable measure, which most certainly is. Furthermore, it is in this last step where proportionality comes into action. This concept is used systematically as a guide in the court's reasoning. Proportionality can be understood in two different outlooks, a positive one or a negative one.[138] When the ECJ employs the negative perspective, proportionality is employed as a control element. Further, I note that according to Daniel S. Smit, the proportionality test obliges for a balance test between the objective pursued by the policy, and the taxpayer's interests.[139] Lastly, the FTT passes the test of proportionality, as the objective pursued has the taxpayer's best-interests in mind.

2.4. Practical Perspective

The preceding perspectives focused predominantly on the territorial design of the tax. Even though the European Commission did not explicitly mention the collection of the tax, the demonstration of administrative feasibility of any tax is fundamental to its implementation, hence the inevitability of including this perspective in the dissertation. There are several complex factors to take into account with tax collection, still, this perspective will only cover the territorial aspect of collection, and the difficulties a broad territorial scope may imply.

The implementation and execution of a tax on the financial sector, known for its creative, fast-passed, dynamic atmosphere, is of extreme administrative intricacy. Even so, such complexity is not exclusive to FTT.[140] According to the IMF, an FTT presents no more tax administration difficulties than other taxes, in some aspects it is actually

[137] See de Lasteyrie du Saillant, paragraph 49; Case C 446/03 Marks & Spencer [2005] ECR I 10837, paragraph 35; and Case C 311/08 SGI [2010] ECR I 487, paragraph 56.

[138] See NOGUEIRA, JOÃO FÉLIX PINTO p. 81 et seq.

[139] See SMIT, DANIEL S., p. 136.

[140] See IMF, *Financial Sector Taxation - The IMF's Report to the G-20 and Background Material* (2010) p. 17.

easier.[141] The tax will be employed progressively, with the primary exemption of certain actors, instruments and markets. The impact assessment argues that the phasing in of a common system, even though necessary, may have negative effects.[142] Tax collection is not regulated in detail in the proposed directive. By only scripting the basic rules and framework,[143] the participating Member States are given a high level of discretion.[144] Nonetheless, a harmonised approach to collection would have advantages.[145]

The proposed FTT is regarded as impractical by many actors due to the extensive territorial scope it entails. The territorial scope extension would not be perceived as a problem if there was European harmonization in this matters, even more if the tax was to be implemented at a global scale. If it was so, every Nation would direct its efforts towards a successful collection of the tax. Neither a European nor globalized harmonization was possible, as only 11 European countries have committed to the implementation of this tax. Nonetheless, collection complications would diminish if the counterparty principle was not included in the proposed directive. With the application of the counterparty principle the other part of the transaction will be taxed in the same conditions as the part which has been established in the FTT-zone. The other part is established in a non-participating Member-State or in a Third Country, therefore, it is sensible to presume that such countries will have objections to the taxation of their national financial institutions, especially as they will not be entitled to the revenues. Furthermore, counterparty identification may prove to be difficult.[146] Participating Member States have limited tools to enforce compliance, still, the configuration of regulatory reporting and the maintenance of tax collection accessible, simple and clear, may help. The transfer of information between participating member states and non-

[141] See BRONDOLO, JOHN D., *Taxing Financial Transactions: An Assessment of Administrative Feasibility*, IMF Working paper (2011) p. 5.

[142] See EUROPEAN COMMISSION, *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts*, p. 43.

[143] Article 11 of the Proposed Directive.

[144] See EUROPEAN COMMISSION, *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts,* p. 53.

[145] See EUROPEAN COMMISSION, FTT-Collection Methods and Data Requirements, (EY. October 2014) p. 3.

[146] See *ibid.,* p. 68.

participating member states tax authorities and the mutual assistance mechanisms in place[147] will greatly influence the practical feasibility of this tax.

The proposed European FTT is gutsier than any other tax enacted on the financial sector, especially taking in mind its broad-scope and territorial reach.[148] As there is no experience in collecting a tax on financial markets with such a broad territorial scope a comparative analysis with other countries is inadequate. The last statement does not apply to the issuance principle, which is already applied successfully by the UK.

A safety net is generated by the inclusion of joint liability, which permits a participating Member State to collect the tax from the counterparty in case the primarily liable financial institution does not timely pay.[149] The payment of tax by both sides of the transaction, as well as being excellent for revenue-raising is, likewise, an exceptional measure for tax-collection purposes, as it allows a comparative control to be made. An important aid in monitoring the collection of revenue is Article 25 (2) of the Markets in Financial Instruments Directive, as it prescribes the obligation of institutions to maintain relevant data on all transactions of financial instruments, including OTC.[150]

Exchange-traded instruments will be more easily affected by FTT, this is because they are traded in an organized platform. Over-the-counter derivatives present the greatest tax-collection difficulties. Difficulties include establishing the territorial coverage of the tax, defining the taxable event, measuring the tax base, identifying the taxable persons and assessing and collecting the tax. All of the latter identified difficulties must be taken into consideration in FTT's design. OTC markets are less formal, where transactions are negotiated by two parties, one of whom is usually a dealer. These markets are known for their lack of transparency.[151] Moreover, OTC markets are extremely diverse among themselves. For OTC instruments which are negotiated in an organized platform, the

[147] A reference must be made to Directive 2011/16/EU of 15 February 2011 on administrative co-operation in the field of taxation and to mutual assistance in recovery obligations under Council Directive 2010/24/EU of 16 March 2010. Also, to ensure the compliance of Third countries' tax authorities the Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax matters is of aid.

[148] See *ibid.,* p. 3.

[149] Article 10 (3) of the Proposed Directive.

[150] See EUROPEAN COMMISSION, , *Impact Assessment, proposal for a COUNCIL DIRECTIVE, Implementing Enhanced Cooperation in the Area of Financial Transaction tax, Analysis of Policy Options and Impacts*, p. 55.

[151] See BRONDOLO, JOHN D., p. 7, 19 and 26.

clearinghouse would charge the tax to the two counterparties and remit the revenue raised to the government. On the contrary, instruments dealt outside clearinghouses', where the counterparties are dealers or brokers, or other major market participants, the two counterparties should be charged half-and-half. Using dealers for collection purposes simplifies and reduces administrative costs. For OTC transactions, where an end-user is part of, an exemption should be in place.[152]

Even though the exclusion of the issuance and counterparty principle, and the consequent reduction of geographic scope, would significantly ease tax collection, it would also inhibit the achievement of the purpose of this tax. Tax policy has to take into consideration the implementation phase and administrative feasibility, still, I do not believe it should limit tax design to such extent.

[152] See *ibid.*, p. 28.

CONCLUSION

It has become clear that the laissez-faire financial capitalism, which prevailed up to the economic crisis, is no longer tolerable. Advocates of fiscal consolidation wish for a smaller financial system, serving the interests of the real economy.[153] By increasing the costs of transactions, the FTT is capable of reducing the size of the financial sector, simultaneously generating high revenues. Even though, in my view, no discrimination results from the FTT, reasoning conveys that the transactions mostly affected by the tax are short-term and speculative. The reduction of volatility and technical trading is thus accomplished. The purpose of placing "sand in the wheels of finance",[154] in other words, stabilizing the financial sector, requires more than tax neutrality, tapping into the corrective potential of taxation.

The sector targeted by the proposed tax is highly responsive to tax design, consequently, policy makers recognized their greatest challenge as being the possible occurrence of substitution behaviour or relocation of activities. Accordingly, definition of the tax's territoriality has significant ramifications, not only on potential evasion but similarly on tax administration. The option to use a cumulative application of the residence, counterparty and issuance principle was certainly audacious, but wise. The aggressive tax avoidance and tax planning measures a tax on financial transactions may trigger, call for a well-structured and well thought-out directive. The only manner for financial institutions to avoid taxation is by giving up customer basis in the FTT-zone States, and not trade financial instruments issued by companies established in those States, which is unlikely to occur.

Opponents of this collaborated action perceive it as an outreach of jurisdiction, nevertheless, this view is based on a lack of understanding of international customary law. Maan successfully articulates that once a counterparty enters into a transaction on an exchange it subjects itself to the rules and regulations of the law governing the exchange, therefore, submitting himself to its jurisdiction. This attribution of jurisdiction is not

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[153] See WATT, ANDREW AND BOTCH,ANDREAS (eds), After the crisis: towards a sustainable growth model, (Etui..2010) p. 5 and 6.

[154] See TOBIN, J., *A Proposal for International Monetary Reform,* 4, Eastern Economic Journal, 153 (1978) p. 158.

discretionary, a balance must be completed.[155] Additionally, all requisites of enhanced cooperation are met and there is no violation of EU primary law.

This dissertation's objective was clear, to consubstantiate the territorial legality and feasibility of the Commission's proposal. The elucidation of the different International Customary Law theories', and establishment of the substantive and genuine connection as the most adequate, served as a basis for the succeeding territorial analysis. It is my conviction that the arguments conveyed in Chapter 2 are sufficient to defend the territorial legality of the directive, and to support its impending application.

[155] MAAN, F.A., p. 203.

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Attachment I – Citation Rules

Bibliographic references are quoted by author, title, editor, edition number (if there is more than one) and year. As for collective work, besides the referred elements, the title of the work is included, preceded by the word *in*, followed by the identification of coordinators, signalised by the expression *ed* or *eds* (if there is one or more coordinators).

For periodic publications, a mention is made to author, work title, volume number, periodic publication's title, beginning of the page of the article and date.

Relative to internet publications, the same order is followed, author, title, editor, edition number and year, preceded by the expressions *available at*, followed by the link to the website.

In the first quote all of the references formerly made are included. In the additional quotes, the author's name is the only reference made, if the author has more than one book, the title of the book is also referred to. If the book was written by more than one author, the name of the first author is referred to, followed by the expression *et al.*

In the case of existing consecutive quotes, referring to the same author and work, the expression *ibid.* is used subsequent to the first quote. In order to refer to the page the expression *p.* is employed, to indicate that the quote likewise refers to subsequent pages, *et al* is applied.

In the final bibliography all the references referred to in this attachment are employed.

Attachment II- The proposed Directive[156]

2013/0045 (CNS)

Proposal for a

COUNCIL DIRECTIVE

implementing enhanced cooperation in the area of financial transaction tax

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 113 thereof,

Having regard to Council Decision 2013/52/EU of 22 January 2013 authorising enhanced cooperation in the area of financial transaction tax[1],

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national Parliaments,

Having regard to the opinion of the European Parliament[2],

Having regard to the opinion of the European Economic and Social Committee[3],

Acting in accordance with a special legislative procedure,

Whereas:

(1) In 2011, the Commission took note of a debate on-going at all levels on additional taxation of the financial sector. The debate originates from the desire to ensure that the financial sector fairly and substantially contributes to the costs of the crisis and that it is taxed in a fair way vis-à-vis other sectors for the future, to dis-incentivise excessively risky activities by financial institutions, to complement regulatory measures aimed at avoiding future crises and to generate additional revenue for general budgets or specific policy purposes.

(2) By Decision 2013/52/EU the Council authorised enhanced cooperation between Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (hereinafter "participating Member States") in the area of financial transaction tax (FTT).

(3) In order to prevent distortions through measures taken unilaterally by the participating Member States, bearing in mind the extremely high mobility of most of the relevant financial transactions, and thus to improve the proper functioning of the internal market, it is important that the basic features of a FTT in the participating Member States are harmonised at Union level. Incentives for tax arbitrage between the participating Member States and

1 OJ L 22, 25.1.2013, p. 11
2 OJ C …, …, p.. .
3 OJ C …, …, p. ..

156 EUROPEAN COMMISSION, *Proposal for a COUNCIL DIRECTIVE, Implementing enhanced cooperation in the area of financial transaction tax*, SWD(2013) 29 final (2013).

allocation distortions between financial markets in those States, as well as possibilities for double or non-taxation should thereby be avoided.

(4) The improvement of the operation of the internal market, in particular the avoidance of distortions between the participating Member States requires that a FTT applies to a broadly determined range of financial institutions and transactions, to trade in a wide range of financial instruments, including structured products, both in the organised markets and "over-the-counter", as well as to the conclusion of all derivative contracts and to material modifications of the operations concerned.

(5) In principle, each transfer agreed upon, of one or more financial instruments, is linked to a given transaction which in turn should be subject to FTT on account of such agreed transfer. Since an exchange of financial instruments gives rise to two such transfers, each such exchange should be considered as giving rise to two transactions, so as to avoid circumvention of the tax. By way of repurchase and reverse repurchase and securities lending and borrowing agreements, a financial instrument is put at the disposal of a given person for a specified period of time. All such agreements, as well as their material modification, should therefore be considered as giving rise to one transaction only.

(6) In order to preserve the efficient and transparent functioning of financial markets or the public debt management, it is necessary to exclude certain entities from the scope of the FTT, in as much as these are exercising functions which are not considered to be trading activity in itself but rather facilitating trade or protecting the management of public debt. However, entities excluded specifically because of their central role for the functioning of financial markets or public debt management should be made subject to the rules that ensure the proper payment of the tax to the tax authorities and the verification of the payment.

(7) The imposition of FTT should not negatively affect the refinancing possibilities of financial institutions and States, nor monetary policies in general. Therefore, transactions with the European Central Bank, the European Financial Stability Facility, the European Stability Mechanism, the European Union where it exercises the function of management of its assets, of balance of payment loans and of similar activities, and the central banks of Member States should not be subject to FTT.

(8) With the exception of the conclusion or material modification of derivative contracts, the trade on primary markets and transactions relevant for citizens and businesses such as conclusion of insurance contracts, mortgage lending, consumer credits or payment services should be excluded from the scope of FTT, so as not to undermine the raising of capital by companies and governments and to avoid impact on households.

(9) The provisions of Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital[4] continue to be fully applicable. Article 5(1)(e) and (2) of that Directive is relevant to the area covered by this Directive and prohibits, subject to Article 6(1)(a) of that Directive, the imposition of any tax whatsoever on the transactions referred to in its provisions. Transactions in respect of which Directive 2008/7/EC prohibits or could prohibit the imposition of taxes should therefore not be subject to FTT. Independently from the extent to which Directive 2008/7/EC prohibits taxation of the issuance of shares and units collective investment undertakings, considerations of tax neutrality require a single treatment of issuances by all these undertakings. The redemption of shares and units thus

[4] OJ L 46, 21.2.2008, p.11.

(20) In order to prevent tax avoidance and abuse through artificial schemes, it is necessary to provide for a general anti-abuse rule. A specific rule based on the same principles should be added with a view to address the particular problems linked to depositary receipts and similar securities.

(21) In order to allow the adoption of more detailed rules in certain technical areas, regarding registration, accounting, reporting obligations and other obligations intended to ensure that FTT due to the tax authorities is effectively paid to the tax authorities, and their timely adaptation as appropriate, the power to adopt acts in accordance with Article 290 of the Treaty on the Functioning of the European Union should be delegated to the Commission in respect of specifying the measures necessary to this effect. It is of particular importance that the Commission carries out appropriate consultations during its preparatory work, including at expert level. The Commission, when preparing and drawing-up delegated acts, should ensure a timely and appropriate transmission of relevant documents to the Council.

(22) In order to ensure uniform conditions for the implementation of this Directive, as regards the collection of the tax in the participating Member States, implementing powers should be conferred on the Commission. Those powers should be exercised in accordance with Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers.[5]

(23) Since market operators will need some time to adjust to the new rules, an appropriate period of time should be provided for between the adoption of the national rules necessary to comply with this Directive and the application of those rules.

(24) Since the objective of this Directive, namely to harmonise the essential features of a FTT within the participating Member States at Union level, cannot be sufficiently achieved by these Member States and can therefore, by reason of improving the proper functioning of the Single Market, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve this objective,

HAS ADOPTED THIS DIRECTIVE:

Chapter I
Subject matter and definitions

Article 1
Subject matter

1. This Directive implements the enhanced cooperation authorised by Decision 2013/52/EU by laying down provisions for a harmonised financial transaction tax (FTT).

2. Participating Member States shall charge FTT in accordance with this Directive.

[5] OJ L 55, 28.2.2011, p. 13

Article 2
Definitions

1. For the purposes of this Directive, the following definitions shall apply:

(1) 'Participating Member State' means a Member State which participates, at the time when FTT becomes chargeable pursuant to this Directive, in enhanced cooperation in the area of FTT by virtue of Decision 2013/52/EU, or by virtue of a decision adopted in accordance with the second or third subparagraph of Article 331(1) of the TFEU;

(2) 'Financial transaction' means any of the following:

(a) the purchase and sale of a financial instrument before netting or settlement;

(b) the transfer between entities of a group of the right to dispose of a financial instrument as owner and any equivalent operation implying the transfer of the risk associated with the financial instrument, in cases not subject to point (a);

(c) the conclusion of derivatives contracts before netting or settlement;

(d) an exchange of financial instruments;

(e) a repurchase agreement, a reverse repurchase agreement, a securities lending and borrowing agreement;

(3) 'Financial instruments' means financial instruments as defined Section C of Annex I to Directive 2004/39/EC of the European Parliament and of the Council[6], and structured products;

(4) 'Derivatives contract' means a financial instrument as defined in points (4) to (10) of Section C of Annex I to Directive 2004/39/EC, as implemented by Articles 38 and 39 of Commission Regulation (EC) No 1287/2006[7];

(5) 'Repurchase agreement' and 'reverse repurchase agreement' means an agreement as defined in Article 3(1)(m) of Directive 2006/49/EC of the European Parliament and of the Council[8];

(6) 'Securities lending agreement' and 'securities borrowing agreement' mean an agreement referred to in Article 3 of Directive 2006/49/EC;

(7) 'Structured product' means tradable securities or other financial instruments offered by way of a securitisation within the meaning of Article 4(36) of Directive 2006/48/EC of the European Parliament and of the Council[9] or by way of equivalent transactions involving the transfer of risks other than credit risk;

(8) 'Financial institution' means any of the following:

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[6] OJ L 145, 30.4.2004, p. 1.
[7] OJ L 241, 2.9.2006, p.1.
[8] OJ L 177, 30.6.2006, p. 201.
[9] OJ L 177, 30.6.2006, p. 1.

(a) an investment firm as defined in Article 4(1)(1) of Directive 2004/39/EC;

(b) a regulated market as defined in Article 4(1)(14) of Directive 2004/39/EC and any other organised trade venue or platform;

(c) a credit institution as defined in Article 4(1) of Directive 2006/48/EC;

(d) an insurance and reinsurance undertaking as defined in Article 13 of Directive 2009/138/EC of the European Parliament and the Council[10];

(e) an undertaking for collective investments in transferable securities (UCITS) as defined in Article 1(2) of Directive 2009/65/EC of the European Parliament and of the Council[11] and a management company as defined in Article 2(1)(b) of Directive 2009/65/EC;

(f) a pension fund or an institution for occupational retirement provision as defined in Article 6(a) of Directive 2003/41/EC of the European Parliament and of the Council[12], an investment manager of such fund or institution;

(g) an alternative investment fund (AIF) and an alternative investment fund manager (AIFM) as defined in Article 4 of Directive 2011/61/EU of the European Parliament and of the Council[13];

(h) a securitisation special purpose entity as defined in Article 4(44) of Directive 2006/48/EC;

(i) a special purpose vehicle as defined in Article 13(26) of Directive 2009/138/EC;

(j) any other undertaking, institution, body or person carrying out one or more of the following activities, in case the average annual value of its financial transactions constitutes more than fifty per cent of its overall average net annual turnover, as referred to in Article 28 of Council Directive 78/660/EEC[14]:

  (i) activities referred to in points 1, 2, 3 and 6 of Annex I to Directive 2006/48/EC;

  ii) trading for own account or for account or in the name of customers with respect to any financial instrument;

  (iii) acquisition of holdings in undertakings;

  (iv) participation in or issuance of financial instruments;

  (v) the provision of services related to activities referred to in point (iv);

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10 OJ L 335, 17.12.2009, p. 1.
11 OJ L 302, 17.11.2009, p. 32.
12 OJ L 235, 23.9.2003, p. 10.
13 OJ L 174, 1.7.2011, p.1.
14 OJ L 222, 14.8.1978, p. 11.

(9) 'Central Counter Party' (CCP) means a CCP as defined in Article 2(1) of Regulation (EU) No 648/2012 of the European Parliament and of the Council[15];

(10) 'Netting' means netting as defined in Article 2(k) of Directive 98/26/EC of the European Parliament and of the Council[16];

(11) 'A financial instrument referred to in Section C of Annex I to Directive 2004/39/EC and structured products issued within the territory of a participating Member State' means such a financial instrument that is issued by a person who has its registered seat or, in case of a natural person, its permanent address or, if no permanent address can be ascertained, its usual residence in that State;

(12) 'Notional amount' means the underlying nominal or face amount that is used to calculate payments made on a given derivative contract.

2. Each of the operations referred to in points (a), (b), (c) and (e) of paragraph 1(2) shall be considered to give rise to a single financial transaction. Each exchange as referred to in point (d) thereof shall be considered to give rise to two financial transactions. Each material modification of an operation as referred to in points (a) to (e) of paragraph 1(2) shall be considered to be a new operation of the same type as the original operation. A modification is considered to be material in particular where it involves a substitution of at least one party, in case the object or scope of the operation, including its temporal scope, or the consideration agreed upon is altered, or where the original operation would have attracted a higher tax had it been concluded as modified.

3. For the purposes of point (8)(j) of paragraph 1:

(a) the average annual value referred to in that point shall be calculated either over the three preceding calendar years or, in the case of a shorter period of previous activity, over that shorter period;

(b) the value of each transaction referred to in Article 6 shall be the taxable amount as defined in that Article;

(c) the value of each transaction referred to in Article 7 shall be ten per cent of the taxable amount as defined in that Article;

(d) where the average annual value of financial transactions in two consecutive calendar years does not exceed fifty per cent of the overall average net annual turnover, as defined in Article 28 of Directive 78/660/EEC, the undertaking, institution, body or person concerned shall be entitled, upon request, to be considered as not being or no longer being a financial institution.

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15 OJ L 201, 27.7.2012, p.1.
16 OJ L 166, 11.6.1998, p. 45.

Chapter II
Scope of the common system of FTT

Article 3
Scope

1. This Directive shall apply to all financial transactions, on the condition that at least one party to the transaction is established in the territory of a participating Member State and that a financial institution established in the territory of a participating Member State is party to the transaction, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction.

2. This Directive, with the exception of paragraphs 3 and 4 of Article 10 and paragraphs 1 to 4 of Article 11, shall not apply to the following entities:

   (a) Central Counter Parties (CCPs) where exercising the function of a CCP;

   (b) Central Securities Depositories (CSDs) and International Central Securities Depositories (ICSDs) where exercising the function of a CSD or ICSD;

   (c) Member States, including public bodies entrusted with the function of managing the public debt, when exercising that function.

3. Where an entity is not taxable pursuant to paragraph 2, this shall not preclude the taxability of its counterparty.

4. This Directive shall not apply to the following transactions:

   (a) primary market transactions referred to in Article 5(c) of Regulation (EC) No 1287/2006, including the activity of underwriting and subsequent allocation of financial instruments in the framework of their issue;

   (b) transactions with the central banks of Member States;

   (c) transactions with the European Central Bank;

   (d) transactions with the European Financial Stability Facility and the European Stability Mechanism, transactions with the European Union related to financial assistance made available under Article 143 of the TFEU and to financial assistance made available under Article 122(2) of the TFEU, as well as transactions with the European Union and the European Atomic Energy Community related to the management of their assets;

   (e) without prejudice to point (c) and (d), transactions with the European Union, the European Atomic Energy Community, the European Investment Bank and with bodies set up by the European Union or the European Atomic Energy Community to which the Protocol on the privileges and immunities of the European Union applies, within the limits and under the conditions of that Protocol, the headquarter agreements or any other agreements concluded for the implementation of the Protocol;

(f) transactions with international organisations or bodies, other than those referred to in points (c), (d) and (e), recognised as such by the public authorities of the host State, within the limits and under the conditions laid down by the international conventions establishing the bodies or by headquarters agreements;

(g) transactions carried out as part of restructuring operations referred to in Article 4 of Council Directive 2008/7/EC[17].

Article 4
Establishment

1. For the purposes of this Directive, a financial institution shall be deemed to be established in the territory of a participating Member State where any of the following conditions is fulfilled:

(a) it has been authorised by the authorities of that Member State to act as such, in respect of transactions covered by that authorisation;

(b) it is authorised or otherwise entitled to operate, from abroad, as financial institution in regard to the territory of that Member State, in respect of transactions covered by such authorisation or entitlement;

(c) it has its registered seat within that Member State;

(d) its permanent address or, if no permanent address can be ascertained, its usual residence is located in that Member State;

(e) it has a branch within that Member State, in respect of transactions carried out by that branch;

(f) it is party, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction, to a financial transaction with another financial institution established in that Member State pursuant to points (a), (b), (c), (d) or (e), or with a party established in the territory of that Member State and which is not a financial institution;

(g) it is party, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction, to a financial transaction in a structured product or one of the financial instruments referred to in Section C of Annex I of Directive 2004/39/EC issued within the territory of that Member State, with the exception of instruments referred to in points (4) to (10) of that Section which are not traded on an organised platform.

2. A person which is not a financial institution shall be deemed to be established within a participating Member State where any of the following conditions is fulfilled:

(a) its registered seat or, in case of a natural person, its permanent address or, if no permanent address can be ascertained, its usual residence is located in that State;

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17 OJ L OJ L 46, 21.2.2008, p.11.

(b) it has a branch in that State, in respect of financial transactions carried out by that branch;

(c) it is party to a financial transaction in a structured product or one of the financial instruments referred to Section C of Annex I to Directive 2004/39/EC issued within the territory of that Member State, with the exception of instruments referred to in points (4) to (10) of that Section which are not traded on an organised platform.

3. Notwithstanding paragraphs 1 and 2, a financial institution or a person which is not a financial institution shall not be deemed to be established within the meaning of those paragraphs, where the person liable for payment of FTT proves that there is no link between the economic substance of the transaction and the territory of any participating Member State.

4. Where more than one of the conditions in the lists set out in paragraphs 1 and 2 respectively is fulfilled, the first condition fulfilled from the start of the list in descending order shall be relevant for determining the participating Member State of establishment.

Chapter III
Chargeability, taxable amount and rates of the common FTT

Article 5
Chargeability of FTT

1. The FTT shall become chargeable for each financial transaction at the moment it occurs.

2. Subsequent cancellation or rectification of a financial transaction shall have no effect on chargeability, except for cases of errors.

Article 6
Taxable amount of the FTT in the case of financial transactions other than those related to derivatives contracts

1. In the case of financial transactions other than those referred to in point 2(c) of Article 2(1) and, in respect of derivative contracts, in points 2(a), 2(b) and 2(d) of Article 2(1), the taxable amount shall be everything which constitutes consideration paid or owed, in return for the transfer, from the counterparty or a third party.

2. Notwithstanding paragraph 1, in the cases referred to in that paragraph the taxable amount shall be the market price determined at the time the FTT becomes chargeable:

(a) where the consideration is lower than the market price;

(b) in the cases referred to in point 2(b) of Article 2(1).

3. For the purposes of paragraph 2, the market price shall be the full amount that would have been paid as consideration for the financial instrument concerned in a transaction at arm's length.

Article 7
Taxable amount in the case of financial transactions related to derivatives contracts

In the case of financial transactions referred to in point 2(c) of Article 2(1) and, in respect of derivative contracts, in points 2(a), 2(b) and 2(d) of Article 2(1), the taxable amount of the FTT shall be the notional amount referred to in the derivatives contract at the time of the financial transaction.

Where more than one notional amount is identified, the highest amount shall be used for the purpose of determining the taxable amount.

Article 8
Common provisions on taxable amount

For the purposes of Articles 6 and 7, where the value relevant for the determination of the taxable amount is expressed, in whole or in part, in a currency other than that of the taxing participating Member State, the applicable exchange rate shall be the latest selling rate recorded, at the time the FTT becomes chargeable, on the most representative exchange market of the participating Member State concerned, or at an exchange rate determined by reference to that market, in accordance with the rules laid down by that Member State.

Article 9
Application, structure and level of rates

1. The participating Member States shall apply the rates of FTT in force at the time when the tax becomes chargeable.

2. The rates shall be fixed by each participating Member State as a percentage of the taxable amount.

   Those rates shall not be lower than:

   (a) 0.1% in respect of the financial transactions referred to in Article 6;

   (b) 0.01% in respect of financial transactions referred to in Article 7.

3. The participating Member States shall apply the same rate to all financial transactions that fall under the same category pursuant to points (a) and (b) of paragraph 2.

Chapter IV
Payment of the common FTT, related obligations and prevention of evasion, avoidance and abuse

Article 10
Person liable for payment of FTT to the tax authorities

1. In respect of each financial transaction, FTT shall be payable by each financial institution which fulfils any of the following conditions:

(a) it is party to the transaction, acting either for its own account or for the account of another person;

(b) it is acting in the name of a party to the transaction;

(c) the transaction has been carried out on its account.

The FTT shall be payable to the tax authorities of the participating Member State in the territory of which the financial institution is deemed to be established.

2. Where a financial institution acts in the name or for the account of another financial institution only that other financial institution shall be liable to pay FTT.

3. Where the tax due has not been paid within the time limit set out in Article 11(5), each party to a transaction, including persons other than financial institutions shall be jointly and severally liable for the payment of the tax due by a financial institution on account of that transaction.

4. The participating Member States may provide that a person other than the persons liable for payment of FTT referred to in paragraphs 1, 2 and 3 is to be held jointly and severally liable for the payment of the tax.

Article 11

Provisions relating to time limits for the payment of FTT, to obligations intended to ensure payment, to the verification of payment

1. The participating Member States shall lay down registration, accounting, reporting obligations and other obligations intended to ensure that FTT due is effectively paid to the tax authorities.

2. The Commission may, in accordance with Article 16 adopt delegated acts specifying the measures to be taken pursuant to paragraph 1 by the participating Member States.

3. The participating Member States shall adopt measures to ensure that every person liable for payment of FTT submits to the tax authorities a return setting out all the information needed to calculate the FTT that has become chargeable during a period of one month including the total value of the transactions taxed at each rate.

   The FTT return shall be submitted by the tenth day of the month following the month during which the FTT became chargeable.

4. The participating Member States shall ensure that financial institutions keep at the disposal of the tax authorities, for at least five years, the relevant data relating to all financial transactions which they have carried out, whether in their own name or in the name of another person, for their own account or for the account of another person.

   In specifying that obligation they shall take account, where applicable, of obligations they have already imposed on financial institutions in view of Article 25(2) of Directive 2004/39/EC.

5. The participating Member States shall ensure that any FTT due is paid to the accounts determined by the participating Member States at the following points in time:

(a) at the moment when the tax becomes chargeable in case the transaction is carried out electronically;

(b) within three working days from the moment the tax becomes chargeable in all other cases.

The Commission may adopt implementing acts providing for uniform methods of collection of the FTT due. Those implementing acts shall be adopted in accordance with the examination procedure referred to in Article 18(2).

6. The participating Member States shall ensure that the tax authorities verify whether the tax has been correctly paid.

Article 12
Prevention of fraud and evasion

The participating Member States shall adopt measures to prevent tax fraud and evasion.

Article 13
General anti-abuse rule

1. An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. Participating Member States shall treat these arrangements for tax purposes by reference to their economic substance.

2. For the purposes of paragraph 1 an arrangement means any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event. An arrangement may comprise more than one step or part.

3. For the purposes of paragraph 1 an arrangement or a series of arrangements is artificial where it lacks commercial substance. In determining whether the arrangement or series of arrangements is artificial, participating Member States shall consider, in particular, whether they involve one or more of the following situations:

(a) the legal characterisation of the individual steps which an arrangement consists of is inconsistent with the legal substance of the arrangement as a whole;

(b) the arrangement or series of arrangements is carried out in a manner which would not ordinarily be employed in what is expected to be a reasonable business conduct;

(c) the arrangement or series of arrangements includes elements which have the effect of offsetting or cancelling each other;

(d) transactions concluded are circular in nature;

(e) the arrangement or series of arrangements results in a significant tax benefit but this is not reflected in the business risks undertaken by the taxpayer or its cash flows.

4. For the purposes of paragraph 1, the purpose of an arrangement or series of arrangements consists in avoiding taxation where, regardless of any subjective intentions of the taxpayer, it defeats the object, spirit and purpose of the tax provisions that would otherwise apply.

5. For the purposes of paragraph 1, a given purpose is to be considered essential where any other purpose that is or could be attributed to the arrangement or series of arrangements appears at most negligible, in view of all the circumstances of the case.

6. In determining whether an arrangement or series of arrangements has led to a tax benefit as referred to in paragraph 1, participating Member States shall compare the amount of tax due by a taxpayer, having regard to those arrangement(s), with the amount that the same taxpayer would owe under the same circumstances in the absence of the arrangement(s).

Article 14
Abuse in the case of depositary receipts and similar securities

1. Without prejudice to Article 13, a depositary receipt or similar security issued with the essential purpose of avoiding tax on transactions in the underlying security issued in a participating Member State shall be considered issued in that participating Member State, in case a tax benefit would otherwise arise.

2. For the purposes of paragraph 1, paragraphs 4, 5 and 6 of Article 13 shall apply.

3. In applying paragraph 1, regard shall be had to the extent to which trade in the depositary receipt or similar security has replaced trade in the underlying security. Where such replacement has occurred to a significant extent, it shall be for the person liable for payment of FTT to demonstrate that the depositary receipt or similar security was not issued with the essential purpose of avoiding tax on transactions in the underlying security.

Chapter V
Final provisions

Article 15
Other taxes on financial transactions

The participating Member States shall not maintain or introduce taxes on financial transactions other than the FTT object of this Directive or value-added tax as provided for in Council Directive 2006/112/EC[18].

Article 16
Exercise of the delegation

1. The power to adopt delegated acts is conferred on the Commission subject to the conditions laid down in this Article.

2. The delegation of powers referred to in Article 11(2) shall be conferred for an indeterminate period of time from the date referred to in Article 19.

18 OJ L 347, 11.12.2006, p. 1.

3. The delegation of power referred to in Article 11(2) may be revoked at any time by the Council. A decision of revocation shall put an end to the delegation of the power specified in that decision. It shall take effect the day following the publication of the decision in the Official Journal of the European Union or at a later date specified therein. It shall not affect the validity of the delegated acts already in force.

4. As soon as it adopts a delegated act, the Commission shall notify it to the Council.

5. A delegated act adopted pursuant to Article 11(2) shall enter into force only if no objection has been expressed by the Council within a period of 2 months of notification of that act to the Council or if, before the expiry of that period, the Council has informed the Commission that it will not object. That period shall be extended by 2 months at the initiative of the Council.

Article 17
Information of the European Parliament

The European Parliament shall be informed of the adoption of delegated acts by the Commission, of any objection formulated to them, or of the revocation of the delegation of powers by the Council.

Article 18
Committee procedure

1. The Commission shall be assisted by a committee. That committee shall be a committee within the meaning of Regulation (EU) No 182/2011

2. Where reference is made to this paragraph, Article 5 of Regulation (EU) No 182/2011 shall apply.

Article19
Review clause

Every five years and for the first time by 31 December 2016, the Commission shall submit to the Council a report on the application of this Directive, and, where appropriate, a proposal.

In that report the Commission shall, at least, examine the impact of the FTT on the proper functioning of the internal market, the financial markets and the real economy and it shall take into account the progress on taxation of the financial sector in the international context.

Article20
Transposition

1. The participating Member States shall adopt and publish, by 30 September 2013 at the latest, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those provisions.

   They shall apply those provisions from 1 January 2014.

   When the participating Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their

official publication. The participating Member States shall determine how such reference is to be made.

2. The participating Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 21
Entry into force

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union.*

Article 22
Addressees

This Directive is addressed to the participating Member States.

Done at Brussels,

For the Council
The President

Attachment III- Common Exchange-Traded Instruments Tables and Common Over-the-Counter Instruments[157]

Table 1. Common Exchange-Traded Instruments

Instrument	Definition
Equities	Equities (i.e., stocks) are financial securities that give the holder an ownership claim to a company. A company may have different types of equities (preferred, common), each with distinctive ownership rules, privileges, or share values. Equities can be private or public: public equities are regulated by government securities regulators and are traded on exchanges; private shares do not require approval by a regulatory body and are traded over-the-counter.
Futures	A future is a contract that obligates the purchaser to buy or sell an underlying asset at a specified price and time. The underlying asset is commonly a single stock or a stock index, a bond, a currency, or a commodity. Futures are traded on an exchange in standardized forms in terms of their contract size and maturity date.
Options	An option is a contract that provides the purchaser (the "holder") with the right (but not the obligation) to buy (a call) or sell (a put) an underlying asset at a specified price ("strike price") over a specified period of time in exchange for the payment of a premium to the seller (i.e., the "writer"). The underlying asset is commonly a stock, bond, commodity, or currency. Most options are traded on exchanges in standardized forms in terms of their contract size and maturity date. Some options and are negotiated over-the-counter, which allows the contract to be customized to meet the needs of the counter-parties.

[157] See BRONDOLO, JOHN D., Taxing Financial Transactions: An Assessment of Administrative Feasibility, IMF Working paper (August 2011) p. 7 and 20.

Table 2. Common Over-the-Counter Instruments

Instrument	Definition
Bonds	A bond is a contract under which the purchaser pays the issuer the face value (principal) of the bond and the issuer pays the purchaser interest and repays the principal according to an agreed schedule. Bonds are issued by governmental or corporate entities, either on a medium-term (notes) or long-term (bonds) basis.
Forward contracts	A forward contract is a contract that establishes an obligation to buy or sell a specified quantity of an item at a specified price or rate at a specified time in the future. Under a forward contract, money changes hands when the contract reaches its maturity date or is sold before maturity. No money changes hands when the contract is first issued. Whereas a futures contract (Table 1) is traded in standardized form on an exchange, forwards are traded over-the-counter and can be customized in terms of amounts and maturity dates to suit the counterparties' preferences.
Contract for difference	A contract for difference (CFD) is a contract where one counterparty will pay the other the difference between the current value of an underlying asset and its value when the contract is entered into, without the need for exchanging ownership of the underlying assets.
Asset-backed securities	An asset-backed security (ABS) is a security whose value and income payments are derived from and collateralized (or "backed") by a specified pool of underlying assets. The underlying assets commonly include payments from mortgage loans, credit cards, and auto loans. More esoteric cash flows involve aircraft leases, royalty payments and movie revenues. Under an ABS transaction, the investor pays the issuer of the ABS (normally an investment bank) the face value of the security and is then entitled to receive the future income generated by the underlying assets generate.
Money market instruments	
Bankers' acceptances	A bankers' acceptance (BA) is a bill of exchange (normally tied to the sale or storage of goods such as an export order) that a nonfinancial firm issues to a bank in exchange for a loan. The bank resells the note in the secondary market at a discount and guarantees its payment. BA's do not bear interest; instead, the investor purchases the BA at a discount and then redeems it for face value at maturity.
Certificates of deposits	A certificate of deposit (CD) is a short-term promissory note issued by a bank for a fixed period during which time the investor cannot withdraw the funds without penalty. When issued, the investor deposits the nominal amount of the CD (principal) with the bank and then receives from the bank periodic interest payments and the principal at maturity.
Commercial paper	Commercial paper (CP) is a short-term promissory note that is usually issued by corporations with high credit ratings. CP can be issued either at discount (in which case investor purchases the paper for less than its face value and receives the full face value at maturity) or interest bearing (the investor purchases the paper at face value and receives periodic interest payments and the face value at maturity).
Inter-bank loans of central bank funds	Referred to as federal funds in the US, these are bank balances that private depository institutions (mostly banks) maintain at the central bank and can be loaned to other depository institutions, usually overnight, for an interest charge.
Repurchase agreements	A repurchase agreement or "repo" is a contract in which a seller agrees both to sell a security to the buyer and to repurchase the security at a specific date and price in the future. The largest part of the market is the overnight market, but longer-term repos are also common.
Treasury bills	A Treasury bill is a short-term security issued by a government. The investor will either pay the government the nominal value (face value) of the bill and receive periodic interest payments plus repayment of principal at maturity or will purchase the bill at a discount from its nominal (face) value and receive the full face value at maturity without periodic interest payments.
Swaps	
Commodity swaps	A commodity swap is a contract between two parties to exchange cash flows based on the price of an underlying commodity (usually an oil price index). Under this type of contract, one counterparty agrees to make a series of fixed payments at specified dates and receive from the other counterparty on the same dates a payment based on either the commodity's spot price at that time or an average price over a period of time.
Credit default swaps	A credit default swap is a contract in which one party (the protection buyer) pays a periodic fee to another party (the protection seller) in return for compensation in the event of a default on a bond or loan by a reference entity (a government or corporation), which itself is not a party to the contract.
Interest rate swaps	An interest-rate swap is a contract between two parties to exchange two streams of interest payments denominated in the same currency. Most commonly, these swaps involve an exchange of fixed-rate for floating rate obligations. Under an interest rate swap, the principal (notional) does not change hands, only the interest payments. Interest rate swaps account for the overwhelmingly largest portion of swaps.

Attachment IV- The contrast between the Swedish and UK's experiences

Swedish experience

In January 1984 Sweden implemented a tax on the purchase and sale of domestic equities at the rate of 0.5% per transaction, these rates were doubled in 1986. The tax applied to all security trades in Sweden which used local brokerage services, it also covered stock options.[158] If two foreign parties were conducting an exchange with a Swedish broker tax liability was only born if the traded security was registered in Sweden.[159] The tax was unable to generate expected revenues and led to a substantial relocation of transactions. Relocation was accomplished by not using Swedish broker services, or by the establishment of off-shore accounts and using foreign brokers to purchase Swedish shares. The Swedish flop can be explained by the implementation of high tax rates and by the reduced jurisdictional scope of the tax, as it only applied to securities traded by Swedish brokers, which made relocation exceedingly uncomplicated and inexpensive.

UK's experience

The UK stamp duty on trades of securities can be divided into two: a stamp duty covering the transfer of financial instruments and a stamp duty reserve tax, otherwise known as SDRT, which was only introduced in 1986. The Stamp Duty Reserve Tax is charged on underlying agreements to transfer securities where an instrument is not executed, it ensures that tax would be payable even where there was no transfer document involved, such as transactions through electronic share dealing systems. Stamp Duty taxes the registration of ownership of a financial instrument. The purchaser is liable to pay the tax, the issuer will only pay the tax when new stock is issued.[160] The tax rate is of 0, 5%, in other words the same as the initial rate of the Swedish FTT. The tax is enacted by the documents used to effect the sale and transfer of ownership in financial instruments of UK-based corporations. The need to register ownership triggers taxation.[161] The British stamp duty is a worldwide tax on ownership transfer of companies incorporated in the

[158] See HEMMELGARN, ET AL, p. 142 et seq.

[159] See SCHULMEISTER ET AL, p. 21.

[160] See *ibid.,* p. 24.

[161] See *ibid.,* p. 140 et seq.

United Kingdom, independently of whether the trader is foreign or domestic.[162] The Stamp Duty is considered a successful tax policy, contrary to the Swedish tax, its success may be attributed to its territorial independence and keen tax design. As the levying of stamp duty is independent of the location of the trade and the investor, large substitution effects do not arise.

It is therefore important to understand what differentiates both taxes, and which tax design features dictate success or failure. In my judgment, the key is to ensure that the tax is not undermined by a limited territorial base, as it will give way to its failure.

[162] See *ibid.,* p. 25.

Attachment V- Substance over form and Anti-avoidance measures in the Proposed Directive.

Anti-avoidance is defined by Justice Reddy as the art of dodging tax without breaking the law, this feature differentiates the concept from tax evasion.[163] Tax planning must be understood as a matter of degree: There are acceptable tax avoidance conducts; on the other side of the spectrum there are transactions which are legal but have the objective of eluding tax structures. Tax avoidance processes are therefore composed of three basic elements: they must be designed to avoid or reduce liability to tax, their sole purpose must be to avoid tax, consequently lacking a commercial purpose, and they must be outside of the legislative intent. Following the Cater Commission report categorization of anti-avoidance provisions, the measure adopted by the proposed directive is known as the administrative approach: a general anti-abuse measure which applies a justice test, whereby the responsibility of identifying these artificial arrangements is left to the discretion of tax authorities.[164] The revised proposal contains a general anti-abuse measure, the objective is to fight artificial arrangements lacking commercial substance and with the essential purpose of avoiding FTT, contrary to the object, spirit and purpose of the regime.

The artificial test of substance over form is a guiding principle in general anti-avoidance rules.[165] FTT's territorial scope is limited by an "economic substance" provision, according to which, if the subject liable for payment proves that there is no economic link between the transaction and the territory of the Member State, then it is not deemed to be established in it. There is no reference to the definition of economic substance nor are there any examples provided. However, the Court of Justice as already intervened in economic substance cases concerning the VAT Directive, which can be used as guidelines for the FTT.[166]

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[163] McDowell &Co Limited v CTO 154 ITR 148 (1985)(India).

[164] SEE ROHATGI, ROY, p. 341 et seq.

[165] See *ibid.,* p. 345.

[166] For example Case C-53/09 and C-55/09 p. 39.