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European Commission

DG TAXUD
Directorate C
Indirect taxation and tax administration
Att. of Mr. Manfred BERGMANN, Director
PER MAIL

Brussels, 26 October 2012

Draft of an EU-directive on a financial transaction tax (FTT)
Taxation of derivative financial instruments

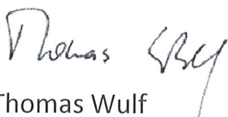
Dear Mr. Bergmann,

With a view on the recent announcements that the process of enhanced cooperation is launched in the field of FTT, we assume that the Commission will again propose or fall back on the draft directive already submitted in 2011.
EUSIPA greatly appreciates the opportunity to comment in this context on the aspects related to the treatment of derivatives.

EUSIPA stands for European Structured Investment Products Association and represents the issuers of note-based and listed Structured Investment Products to retail customers. Our members are national industry associations from Austria, France, Germany, Italy, Sweden and Switzerland. Members of these national associations are major banking institutions. The product landscape in the EU's main markets provides for a volume (called open interest) of around 240b Euro, including Switzerland of around 430b Euro (Q2 2012).

Together with our standing tax adviser, Mr. Hamacher of Axis LLP, I remain at your full disposal for any questions arising from the position set out in the attached document.

Sincerely,



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Comments on the project of an EU-wide financial transaction tax

Below comments refer to draft directive COM (2011) 594 final, dated 28.09.2011. Currently, this draft envisages a divided tax rate and foresees in respect of derivative agreements, that the taxable amount shall be the notional value, whereas the purchase value shall be applicable in terms of other financial instruments. Thus, the tax rate for derivatives shall be considerably lower as in the case of other financial instruments (0.01% instead of 0.1%).

Overall, we would however come to the conclusion that this target will not be reached as the tax burden for derivatives is likely to increase eight- to twentyfold under the application of these provisions.

Furthermore, we assume that not only will financial markets considerably be affected by these provisions but also will the non-financial economy. In particular, the provisions will impact those branches which are obliged to close hedge transactions on a large scale or act directly in the area of commodity derivatives.

1. **Incoherent taxation**

A divided tax rate leads to divided markets and inequitable break lines within the fiscal law.

It is self-evident that no real differentiation exists between derivatives and other financial instruments. Often derivatives are incorporated into "standardised" financial instruments (e.g. index loans, index options, exchangeable bonds or convertible bonds etc.) It might hence be challenging to determine whether the financial instrument is subject to higher or lower taxes.

Due to the compatibility of the financial instruments among each other and given the easy change in form of appearance, the taxable base of taxable instruments ought to be largely identical. Therefore, in terms of derivatives, it is important to determine the so-called economic value, which then would represent the taxable base.

The ambivalence of financial instruments quickly becomes apparent when taking the example of an option. In case the option is regarded as a derivative, which is in line with present suggestions, a completely different taxation would apply compared to the situation that the option is seen as security. In the latter case the option could be regarded as "simple" financial instrument acquired in the market. The purchase price, which would be the option price but not the option's notional value, would then consequently form the taxable base.

The problem of the legal format's exchangeability is toppled by the fact that most EU civil laws do not know the distinction between derivative and securitised instruments.

A further problem concerns the number of the transactions counted in a stock exchange trade. So far, the directive prescribes that each transaction shall be considered single, regarding both future and option trades. Summing up opening- and closing transactions, there would be at least eight taxable transactions. (see also point 2a below).

In fact any such taxation would not be appropriate. In this respect it also has to be considered, that a future trade can easily be converted into a certificate or into a forward contract. These instruments are part of the retail market and can for that reason be simply adjusted bilaterally to another format.

Consequently, the tax might have the effect that some contracting parties leave the stock exchange and execute their trade OTC, what would surely be an unintentional regulatory effect both in terms of consumer protection and preservation of the exchange business.

Finally, no systemic or other threat emanates from a derivative for the financial market which serves as insurance for other financial instruments (hedge transaction). On the contrary, the taxation of such transactions could severely impact their insurance function. Therefore, hedge transactions should be exonerated from any taxation.

Last not least, there are also numerous other problems (i.e. securities lending, backing of certificates) which should be resolved.

2. Conclusions for the definition of the guideline

Present considerations concerning the economic value of derivatives need to reflect in our eyes the following items:

a) Taxable base / options

Regular stock exchange procedures and contract chains could lead in a single option trade to at least four taxable business transactions (customer A – market A – Clearing House – Market – Maker B - customer B), with clearing house transactions not being included as they are exempt from tax.
As the same chain rolls out in the closing transaction the number of the taxable transactions could even double to eight. In case the local bank acts as intermediary, as is the case frequently, further transactions would be generated (again counting each time for opening and closing). It is unknown in this context whether article 9, point 3 of the Commission's directive proposal mentioned above can be considered here, but even so the number of eight transactions still remains in each constellation a potential assumption.

A comparison with OTC trades, where only a single transaction is required between the contracting parties, shows that such a situation can be avoided. Therefore it seems worth to apply special provisions for exchange trades, probably linking them for tax purposes (only) to the opening transaction at the clearing house, for example.

b) Taxable base / futures:

Rather than trying to establish the contract value, it seems in our eyes preferable to take into consideration the profit that derives from opening and closing transactions. However under most European tax regimes Germany, this is not requested from a fiscal point of view, as the closing payments shall be executed after the appropriate period. <u>Therefore, it could be considered to rely on the first margin value.</u>

Technically however, the margin does not represent a purchase value in deed, but only a form of a security deposit. However, it reflects (fictively) the value of the agreement, as the margin is being calculated from an imaginary closing at the end of each trading day, thus from the current amount of the future engagements. It is understood that taxes shall only be raised once for each

trade (necessarily this applies to the opening transactions only, as margins are not known to closings) and should be correspondingly defined as fictive taxable base within the statute.

c) Taxable base / swaps:

It would in our eyes not form a suitable taxable base to rely on swap volume as calculation base.

National income tax laws, e.g. in Germany, rely on particular compensation payments. This we would however not consider suitable for a FTT, as the FTT does not focus on revenues but on the contract value instead. Despite this aspect being still under consideration, the value of the interest swap will result from the stipulated swap rate and the valid market interest rate, in each case based on the contractual period. Technically speaking, the "basis point value", as a risk assessment, generates the swap value. It is hence a matter of sophisticated evaluation similar to the determination of assets. Last not least, the market value of a fixed interest asset finally also depends on the development of the particular market interest rate, and so does the swap in the end.

More generally, acknowledging in particular the enormous problems that the formation of a solid taxable base causes, we think that the approach taken by France (and presumably in the future also by Spain), to exclude derivatives in general when introducing the national FTT, is worth being supported also on the EU level.

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