

ICI VIEWPOINTS

APRIL 10, 2013

The Extraordinarily Extraterritorial Proposal to Tax Global Financial Transactions

By Keith Lawson

The financial transaction tax (FTT) being considered by several European countries would have an extraordinary extraterritorial effect. The tax would crash across borders. All investors would be hit. The economic link triggering this tax, as explained below, need be no thicker than a blade of grass.

Background: FTT Rejection and Lessons from the Swedish FTT Debacle

The extraterritorial features of the [European FTT proposal](#) are the direct result of two rejections—first by the Group of 20 and then by the European Union—of proposals for a global, and then an EU-wide, FTT. Concerns exist that, absent a broadly applicable tax, financial transactions will migrate from countries adopting the tax to ones (such as the United States and the United Kingdom) that steadfastly refuse to tax these transactions.

The European Commission, which crafted the proposal being considered by only a minority of EU member states, clearly learned from the Swedish experience. Specifically, Sweden decimated its financial markets by enacting an FTT in 1984, increasing the tax rate in 1986 and again in 1987, and then extending the tax to bonds in 1989. Following an 85 percent decline in trading in long-term bonds and a migration of half of all trading in Swedish stocks to non-Swedish markets (such as London), the tax was modified in 1990 and repealed in 1991.

The Commission was determined to prevent European countries adopting the Commission's proposal from suffering Sweden's fate. The only way to prevent that fate, however, is to advance a tax that applies beyond the adopting countries' borders. To achieve the desired end, the Commission has proposed an extraterritorial tax that applies based on either the country in which a financial instrument or product is treated as issued (the issuance principle) or the country in which the investor is treated as residing (the residence principle).

Adding to the proposal's extraordinary breadth, the tax applies to *each* transfer of a security—even if a financial intermediary is acting as a market maker and purchasing a security for sale to a customer. Without a market maker exception, a common feature of other FTTs, the tax cascades through each step in a transaction. The extraterritorial impact of the European proposal is compounded by this cascading effect.

Yet, some proponents of the European FTT assert that the proposal has no extraterritorial effect because an “economic link” must exist between the transaction and the country asserting the tax. This denial of the proposal's breadth is striking. Let's look at the facts.

Taxation Based upon Issuance

The European proposal would tax financial institutions on transactions involving most financial instruments (including stocks and bonds) and structured products that are “issued within” any participating member state. The tax would apply regardless of the country in which the instrument or product trades.

The proposed FTT would have broad extraterritorial effect. The FTT would apply, for example, to:

- the sale on the Tokyo Stock Exchange of the shares of a German company,
- a secondary market purchase in Singapore of Italian government bonds, and
- the sale on the New York Stock Exchange of an American Depositary Receipt (ADR) on a French stock.

Existing FTTs have little, if any, extraterritorial effect. Typically, these taxes apply only to financial institutions operating within the taxing country or only to trades on local exchanges. As the European Commission has noted, the UK stamp duty is somewhat broader in that it does apply, outside of the United Kingdom, to sales of shares in a UK company. The stamp duty nevertheless is quite limited in that it does not apply to transactions in the United Kingdom of non-UK stocks; likewise, it does not apply to transactions anywhere in the world involving bonds or contracts for difference (a derivative similar to an ADR).

In sum, under the issuance principle, the European proposal is *exponentially* more extraterritorial than existing FTTs. Even the UK stamp duty is about as similar to the European proposal as a single blade of grass is to Wimbledon's Centre Court.

Taxation Based upon Residence

The European proposal also would tax financial institutions on covered transactions involving any person (including an individual) "established" in a participating member state. The tax would apply regardless of the country in which the transaction occurs.

The residence principle leads to greater extraterritorial effect than the issuance principle. Not surprisingly, a financial institution is treated as established in a participating member state if it is authorized to act within that state or has a branch within that state. Absolutely extraordinarily, however, a financial institution also is treated as established in a participating member if its counterparty is so established. Individuals are treated as "established" in the country of their "permanent address."

To illustrate how thin a link is sufficient under the proposal to impose the FTT outside of Europe, consider a U.S. fund with an individual shareholder who lives in the United States but who has a permanent address in Belgium. Under the proposal, the U.S. fund is treated as established in Belgium for purposes of any transaction involving that shareholder. Similarly, an Australian fund buying a Peruvian stock from an Austrian broker would be treated as established in Austria (rather than Australia) for purposes of the Peruvian stock sale.

No country attempts to apply its FTT in this manner. Among other reasons, no mechanism exists for collecting a tax so far from home from parties with no effective connection to the taxing state.

Contrary to assertions made by some, the Foreign Account Tax Compliance Act (FATCA) rules enacted by the United States are not precedential. Unlike the European proposal, which would require tax to be collected wherever in the world a transaction occurs (and then remitted to the country in which the institution is *deemed* to be established), FATCA requires U.S. withholding agents to collect tax only on payments made *in the United States* to institutions that do not agree to comply with FATCA.

To return to the blades of grass analogy, given the added extraterritorial breadth of the residence principle, comparing existing FTTs to the European proposal is like comparing a single blade of grass to London's Hyde Park. The extraordinarily extraterritorial effect of this proposal simply cannot be denied.

Learn more about FTTs at [our resource center](#).

Keith Lawson is Senior Counsel, Tax Law, for ICI and ICI Global.