

EU FTT: UK's challenge blocked for now but UK Treasury indicates they will not let it be

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In brief

In April 2013, the UK launched a legal challenge against the introduction of an EU Financial Transaction Tax ("EU FTT") under the Enhanced Cooperation Procedure ("ECP"). Yesterday the Court of Justice of the European Union ("CJEU") released its decision on the UK's challenge. The judgment rejected the challenge as premature, on the basis that any challenge would need to be made against a final, adopted Directive for the EU FTT. On one hand, the UK Government has therefore failed in its attempt to prevent the introduction of an EU FTT. However, yesterday's decision certainly falls short of positive confirmation of the legality of the EU FTT. The decision leaves open the possibility of future challenges to the legality of the regime by the UK (or indeed other non-Participating Member States), a fact that has not gone unnoticed by the UK Treasury.

Background

Following the release of the first draft for an EU FTT in 2011, it became clear that the proposal would not find support across all EU Member States. As a result, 11 Participating Member States ("the EU-11") requested the use of the Enhanced Cooperation Procedure ("ECP") to introduce an EU FTT. This was authorised by the ECOFIN Council in January 2013, following consent by the EU Parliament.

Under the latest draft Directive, released in February 2013 (the "Proposed Directive"), countries outside of the EU-11 could fall within the scope of the tax when transacting in securities issued in one of the EU-11 States (the "issuance principle") or when transacting with a counterparty in one of the EU-

11 States (the "counterparty principle").

The UK, which has been opposed to the EU FTT from the outset (primarily due to the potential impact on the City of London), challenged the use of the ECP in this context in April 2013. Yesterday, much sooner than many had originally predicted, the CJEU released its decision on the UK's legal challenge.

What were the grounds for the UK's challenge?

The UK had challenged the decision by the ECOFIN Council to authorise the use of the ECP by the EU-11 to implement an EU FTT on three counts:

1. The EU FTT is contrary to EU law on the basis that it has an extraterritorial effect on EU Member States outside of the EU-11 (this effect results from

the counterparty and issuance principles described above).

2. The EU FTT is contrary to international law on the basis that it has extraterritorial effect.

3. The EU FTT is contrary to EU law as it will result in Member States outside of the EU-11 incurring costs in implementing and collecting the tax.

What did the CJEU find?

The CJEU yesterday dismissed the action brought by the UK. The CJEU found that it is not possible to review the aspects of the EU FTT on which the UK had based its challenge and made it clear that no decision was possible on these points until the Proposed Directive has been adopted. The Court noted that the decision of the Council to implement the ECP "...does no more than authorise

the establishment of enhanced cooperation, but does not contain any substantive element on the FTT itself”.

Importantly, the decision left open the possibility of a future challenge to the legality of the EU FTT once the final version of the Directive is adopted.

Why did the UK launch the challenge?

As noted above, the UK has been opposed to the EU FTT from the release of the first draft EU FTT Directive in September 2011. In early 2013, the UK Government was under significant pressure from the House of Lords to engage in the EU FTT discussions given the potential impact of the tax on the UK economy and the FS sector in particular. A letter sent to the UK Treasury by the House of Lords explicitly called on the UK Government to consider mounting a legal challenge to the use of the ECP¹.

In addition, the UK Government was concerned that, if it did not challenge the use of the ECP at this stage in the process, it may be prevented from challenging a final, adopted Directive for an EU FTT at some later stage. Whilst in light of yesterday’s CJEU decision the UK’s challenge could be seen as premature, the timing of the challenge was driven by a requirement to lodge challenges within 12 weeks of official authorisation by the ECOFIN Council of the ECP process.

It is also worth remembering that this is the first time the ECP has been used to implement a tax measure. It was perhaps unsurprising therefore that an early challenge was mounted to explore the legality of the procedure given this context.

The UK’s challenge can therefore be seen as a measure to keep the option of future legal challenge open. Indeed, following the decision a spokesman for the UK Treasury announced that, as recognised in the Court’s judgment, “...the UK will be able to challenge the final proposal for a financial transaction tax if it is not in our national interest and undermines the integrity of the single market”. This shows that the UK has not ruled out future challenges and will remain a key stakeholder as negotiations on the precise scope of the tax continue.

Where does this leave the EU FTT?

Despite the rejection of the UK’s challenge, the CJEU’s decision is not a positive confirmation of the legality of the introduction of the EU FTT set out in the Proposed Directive. The decision makes clear that whether the use of the ECP is legal in this context will depend on the final agreed scope and details of the tax.

With respect to the legality of the proposed EU FTT, the CJEU did not comment on the components of the Proposed Directive. It therefore remains unclear whether the EU FTT regime as currently proposed is contrary to EU or international law. It is well known that conflicting opinions on this point have already been produced by the European Commission’s Legal

Service and the Council’s Legal Service.

The UK’s legal challenge should also be seen in the context of other challenges made in relation to existing, domestic FTT regimes which are based on the issuance principle. For example, in 2013 German banks lodged complaints to the Commission of Ministers regarding the legality of the French FTT and Italian FTT.

What happens next?

A further announcement on the progress of negotiations between the EU-11 on the scope of the EU FTT is expected on 6 May 2014, following the next ECOFIN meeting.

Given the differences of opinion between the EU-11 on various aspects of the proposal, and the significant work still required in order for these differences to be reconciled, it is increasingly likely that any EU FTT ultimately adopted will require a phased or “progressive” introduction, with a narrow form of the tax implemented as a first measure (such as a tax on equities and certain derivatives).

The fact that the UK has its own FTT on equities, in the form of Stamp Duty Reserve Tax, may be a factor considered by the EU-11 in assessing the risk of any future legal challenge by the UK. In our view, unless significant structural changes are made to the EU FTT as proposed in its current form, future legal challenges appear likely.

¹ See <http://www.parliament.uk/documents/lords-committees/eu-sub-com-a/FTTEnhancedScrutiny/260313FTT.pdf>

In conclusion

Overall, the CJEU judgment does not really move the debate regarding the EU FTT any further forward. Attention now turns to the ECOFIN meeting on 6 May where it is hoped that further clarity will be provided by the EU-11 on the scope of the tax and the timing of its implementation.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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