

European Court throws out the UK's challenge to the FTT

The European Court today rejected the UK's legal challenge to the proposed EU financial transaction tax on procedural grounds. A substantive challenge may follow if the FTT's proponents proceed with the more ambitious proposals currently on the table. In our view such a substantive challenge would likely succeed.

What was the UK's challenge?

In January 2013, the Council of Ministers authorised France, Germany and nine other EU Member States to proceed with a wide-ranging EU financial transaction tax (FTT) on securities and derivative transactions. The Commission published a detailed proposal on 14 February 2013.

The FTT would be applied under the "enhanced cooperation procedure". This enables EU legislation to be enacted by eleven or more Member States (forming the "FTT zone"), without other Member States having a right of veto.

The UK announced in April 2013 it was challenging the decision of the Council to allow the enhanced cooperation procedure to proceed.

The proposed FTT applied in two scenarios:

- First, much like UK stamp duty or the French and Italian FTTs, it applied to transactions in securities issued by a company in the FTT zone. This is the so-called "issuance principle" and is relatively uncontroversial.
- Second, it applied to transactions entered into by a financial institution resident in the FTT zone, even where the subject securities or derivatives had no connection to the FTT zone. This is the "residence principle", and has been much more controversial from a legal and political perspective.

The residence principle was given extra-territorial effect – a financial institution resident outside the FTT zone would be deemed resident in the FTT zone when transacting with an FTT zone party. So, for example, a UK bank selling US Treasuries to a German bank would be deemed resident in Germany and subject to the FTT in Germany. This would be the result even if the German bank was acting through its London branch.

Our previous [client briefing](#) set out the proposed FTT in more detail.

What were the grounds of the UK's challenge?

The UK's challenge was on three separate grounds:

First, that the proposed FTT breaches the requirement in Article 327 of the Treaty on the Functioning of the European Union that any enhanced cooperation measure must respect the "competences, rights and

2 European Court throws out the UK's challenge to the FTT

obligations" of non-participating Member States. The UK argued that the FTT's wide extra-territorial application and its potential impact on UK businesses meant that this condition was failed.

Second, the related argument that the FTT's wide extra-territorial effect contravened norms of international law (which EU Treaties require EU institutions to follow).

Third, that the FTT breaches the requirement in Article 332 TFEU that expenditure resulting from implementation of enhanced cooperation measures must be borne by the participating Member States. This was on the basis that some of the cost of collecting and enforcing the FTT would be borne by the UK through the Mutual Assistance Directive.

What did the Court decide?

In a short judgment, the Court of Justice of the European Union (CJEU) ruled that none of the above consequences necessarily followed from the decision of the Council, as the decision simply authorised the use of the enhanced cooperation procedure. Those consequences would follow (if at all), not from that authorising decision, but from the subsequent implementation of the Council's decision in a Directive agreed by the participating Member States.

Accordingly the Court rejected the UK's challenge as premature and declined to rule on the substantive questions. It remains open to the UK to challenge any subsequent Directive which may be enacted.

This result is unlikely to come as a surprise to the UK – not least because there was an equivalent result last year when Spain and Italy challenged the Council's decision to authorise enhanced cooperation in the field of patents.

Why then did the UK launch a challenge at this stage, instead of waiting for a final Directive to be agreed?

As the Court today acknowledged, this was a precautionary challenge, intended to preserve the UK's right to challenge any final Directive (i.e. so that it could not be argued such a challenge was out of time, and should have been made against the Council's original authorising decision).

The challenge may also have been, at least in part, a political statement of purpose - intended to show the UK Government's readiness to challenge any future Directive that infringes on what it sees as its vital interests.

What happens next?

There has been very little progress on the FTT since early 2013. The participating Member States have been unable to agree on whether the FTT should be introduced in the very wide form proposed in the 14 February 2013 draft Directive, or in a more limited form akin to UK stamp duty and the French and Italian FTTs.

However we understand that there is now increased political momentum to reach agreement, and an announcement may be forthcoming after the 6 May 2014 ECOFIN meeting.

Reports suggest that the participating Member States may be close to agreeing a compromise involving phased implementation of the FTT:

- The initial scope would be limited to equities with issuers in the participating Member States, plus derivatives over those equities. There would be no "residence principle". This would therefore be in essence a somewhat expanded version of UK stamp duty and the existing Italian and French FTTs, for which see our briefings [here](#) and [here](#)).
- The second phase of implementation would see the FTT expanded into a much more ambitious tax, taxing derivatives in general and possibly also debt securities (and potentially re-introducing the controversial residence principle).

There are two ways this phased implementation could be achieved. The details of the second phase could be finalised now, but with implementation delayed. Alternatively the second phase could be aspirational, with the details left open for now but to be subsequently agreed between the participating Member States in the form of

3 European Court throws out the UK's challenge to the FTT

a second Directive. The former approach may be viewed as politically more attractive by the FTT's proponents - but it is unclear whether so complex a tax can be agreed within a reasonable timeframe.

When would the FTT come into force?

Any final Directive would have to be implemented by each participating Member State through national legislation. Tax authorities and financial institutions would then need to build the systems required to assess and collect the tax.

To achieve full implementation within a year seems highly ambitious; however the political desire to implement an FTT speedily may result in an extremely streamlined implementation process – early 2015 remains a possibility. That may be achievable from a legislative perspective, particularly if a relatively simple form of the FTT is adopted – but many are concerned taxpayers would not be ready and the resultant uncertainty could be disruptive.

Will the UK launch another legal challenge?

This will depend on the content of any final Directive.

If the Directive is limited to a UK stamp duty-style tax based on an issuance principle, with limited extra-territorial features, then we wouldn't expect a further UK challenge.

If, however, the Directive implements a more extra-territorial tax, and – in particular – taxes UK financial institutions through a residence principle, then we would expect another UK challenge.

Will others challenge the FTT?

At the point a final Directive is adopted it may only be challenged by other EU institutions or Member States.

However once the Directive is implemented into national law, it will be potentially open to challenge by any taxpayer that pays the FTT. Such challenges would initially be in the local courts of the taxing Member State, but ultimately would likely result in a CJEU hearing. Given the sums the FTT is expected to raise, and the legal controversies that it has attracted, we would regard such taxpayer challenges as inevitable – regardless of the precise form the FTT takes.

What will the effect of such challenges be?

Any subsequent challenges to the FTT by the UK would likely take two or three years to be heard. Challenges by taxpayers would take longer (as they must first progress through national courts). This would not prevent or delay implementation of the FTT.

If the CJEU did find elements of the FTT to be unlawful then this could result in substantial refund claims by taxpayers – the CJEU's recent judgment that aspects of UK stamp duty were unlawful is expected to cost the UK several billion pounds of refund claims.

How likely are such challenges to succeed?

That depends on the scope of the final FTT.

If it is to be limited to locally issued equities, like UK stamp duty or the French/Italian FTTs, then we see little prospect for successful EU law challenges (although that may not prevent them being brought).

The prospects for a successful challenge would, on the other hand, be greatly increased if the most controversial features of the Commission's original proposal are retained – particularly the extra-territoriality and the potential for cascading charges in settlement chains (see our previous client briefings [here](#) and [here](#)).

We see an FTT with those features as vulnerable to EU challenge, either on the basis of the arguments raised by the UK in its initial challenge or (more likely in our opinion) on the basis that a broad-ranging FTT fundamentally contravenes the EU "fundamental freedoms" of movement of capital, goods and services.

4 European Court throws out the UK's challenge to the FTT

It is our view that, on the basis of existing CJEU caselaw, an FTT which is imposed extra-territorially and exhibits cascade effects would most likely be contrary to EU law.

What steps should market participants be taking now?

We remain of the view that it is premature to spend management time or incur legal costs planning for the introduction of the FTT when its future remains so uncertain. Please speak to your usual Clifford Chance contact if you would like to discuss how we see the FTT progressing, or speak to one of the contacts listed overleaf.

Authors

Dan Neidle

Partner, London Tax
+44 207 006 8811
dan.neidle@cliffordchance.com

Eric Davoudet

Partner, Paris Tax
+33 14405 5272
eric.davoudet@cliffordchance.com

Pablo Serrano de Haro

Partner, Madrid Tax
+34 91590 9470
pablo.serrano@cliffordchance.com

Ate Veenstra

Partner, Amsterdam Tax
+31 207 119711
ate.veenstra@cliffordchance.com

Chris Bates

Partner, London Regulatory
+44 207 006 1041
chris.bates@cliffordchance.com

David Harkness

Partner, London Tax
+44 207 006 8949
david.harkness@cliffordchance.com

Carlo Galli

Partner, Milan Tax
+39 0280 6341
carlo.galli@cliffordchance.com

Alexander Anichkin

Partner, Moscow Tax
+7 495258 5089
alexander.anichkin@cliffordchance.com

Habib Motani

Partner, London Regulatory
+44 207 006 1718
habib.motani@cliffordchance.com

Uwe Schimmelschmidt

Partner, Frankfurt Tax
+49 697199 1628
uwe.schimmelschmidt@cliffordchance.com

François-Xavier Dujardin

Partner, Luxembourg Tax
+352 4850 50254
francois-xavier.dujardin@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

© Clifford Chance 2014

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.