

**EFAMA Position Paper**  
**Financial Transaction Tax**  
*Comments on the latest proposal of the EC for a FTT Directive*

**I. General remarks**

EFAMA is the representative association for the European investment management industry. EFAMA represents through its 28 member associations and 62 corporate members EUR 21 trillion in assets under management of which EUR 12.6 trillion managed by 56,000 investment funds at end 2015. Just over 30,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 25,900 funds composed of AIFs (Alternative Investment Funds). Our industry provides significant and stable flows of finance to the European economy.

This position paper sets the views of the European investment management industry with regards to the impact of the proposed Financial Transaction Tax on this industry.

EFAMA is highly concerned about the introduction of a Financial Transaction Tax (“FTT”) under the enhanced cooperation and has always expressed its deep concerns and serious objections to the FTT.

EFAMA considers that FTT will be a tax on European consumers, as there is no doubt that it will be borne by consumers as investors. This additional burden will especially be detrimental for investments made by small businesses, ordinary citizens, pensioners and savers. EFAMA would like to stress that the proposed FTT, even in its revised version, continues to have significant and undesirable impact on investment funds, which, in line with applicable accounting rules, will have to treat FTT as a cost that will directly and mechanically reduce the return on investment for investors. Those investors that will most negatively be impacted will typically be small business managing their liquidities through money market funds, ordinary citizens investing for saving purposes or for retirement purposes where investment funds are seen as alternatives to other more traditional investment or saving means in the current context of a very low interest rate environment. As well, the impact of FTT on money market funds would have a huge damaging impact on the whole finance economy. More detailed developments and examples in this respect are provided here below.

EFAMA also has concerns whether these rules could decrease the interest of performing financial activities inside of the 10 participating Member States area and could therefore distort the creation of a Single Market for capital for the Member States. Even if FTT is implemented across all EU Member States, its introduction would be detrimental for EU financial markets as it would increase distortion on the market and encourage entities to relocate their financial activities outside the EU. It would also reduce the value of existing investments in companies which would fall under the FTT.

EFAMA has analysed the latest proposal of the European Commission for a Financial Transaction Tax Directive. In the following we would like to comment on the major concerns which arose while studying this updated proposal.

## II. Double Taxation

**EFAMA believes that it is crucial to maintain the constant principle of equal treatment between indirect and direct investment.** Therefore, EFAMA highly welcomes the proposed exemption of primary market transactions in financial instruments including the activity of underwriting and subsequent allocation of financial instruments in the framework of their issue (Article 3 No. 4 (a)). Even if the proposal utilizes the expression “issue” instead of “subscription to shares” EFAMA assumes and highly welcomes that subscriptions to shares and units of collective investment undertakings are exempt as primary market transactions.

EFAMA is also strongly in favour of the proposed exemption of transactions relating to the redemption (=selling back to the fund, which is the issuer) of shares and units of collective investment undertakings (Article 2 (2) (d)).

We are however concerned that secondary market activities of collective investment undertakings are not exempt. In such secondary market activities investors are trading shares of collective investment undertakings that currently exist. This is in particular the case for shares or units of ETFs. In the secondary market, investors bargain with each other or with third parties (**not** with the collective investment undertaking itself) to trade the existing supply of shares.

EFAMA believes that not exempting secondary market activities of collective investment undertakings triggers double taxation because both, the transactions in the portfolio of investments of the fund, as well as the transactions of the fund units themselves (purchase and sale) will be subject to the Financial Transaction Tax.

This effect might even be reinforced in case of Funds of Funds or Master-Feeder structures. In a master-feeder structure the assets of the feeder funds are invested in a common master fund. The master fund is invested in the targeted financial instruments. The intention of this structure was to decrease the costs for relatively small funds by offering them the benefits of scale. This concept is in danger to be destroyed by the implementation of a FTT.

To realize the objective of an equal treatment between direct and indirect investment, it is essential to exempt also from FTT purchases and sales of shares and units of collective investment undertakings realized on the secondary market, as it is in particular the case for shares or units of ETFs. Otherwise investors might move away from the investment fund industry in countries that levy an FTT as a whole.

This would be a very unfortunate development as the economies of scale from investments held through investment funds give investors access to markets, appropriately diversified, in which investors would otherwise not be able to invest. In case small investors had to invest directly, they would incur substantial time and costs, not to mention the lack of market diversification. In the current investment climate it is imperative that investors are able to diversify risks across investments and international markets.

### **III. Pension Funds**

EFAMA understands that Pension Funds are not FTT exempt according to the latest proposal for a FTT directive of the European Commission. However, the “State of play” document issued by the European Council on 28 October 2016 states that further analysis with regard to pension funds is required. EFAMA would highly appreciate an exemption for Pension Funds.

However, EFAMA would like to point out that a full exemption can only be reached if some further aspects are taken into account. Firstly, in a transaction with a non-exempt counterparty, that counterparty is likely to factor its FTT burden into the transaction price. Secondly, the existing portfolio of capital accumulation systems is reduced in value by the total tax burden on the portfolio. These issues have to be taken into account as the FTT should not harm the Pension Fund system and thereby inter alia the retirement plans of small investors.

Moreover, since pension funds usually hold their investments in financial instruments indirectly through investment undertakings (such as UCITs and AIFs), we recommend to provide an exemption also for transactions made by any undertakings, regardless of their legal form, where all their investors are pension funds or that are constituted and operated exclusively or almost exclusively to administer or provide retirement or similar benefits like e.g. employee savings.

### **IV. Increased cost of capital**

EFAMA would like to underline the fact that the proposed FTT would increase the cost of raising debt and equity capital for issuers in the FTT zone. The increased costs will be included in the cost of capital for all entrepreneurs. From a market perspective especially smaller parties / investors will have to bear a larger share of the burden of these increased costs of capital, because the price of capital also depends on the scale of individual investments.

### **V. Derivatives can easily escape taxation**

The draft proposal encompasses derivatives. It should however be realised that a party offering a derivative on a financial instrument issued in a G-10 country, does not necessarily have to issue that derivative in the same country of issuance as the financial instrument of which it is a derivative. It is therefore likely that most derivatives business will leave those FTT-countries to be issued and traded in a non-FTT country. That would seriously affect also the tax income from the FTT.

### **VI. Relocation of portfolio management activities**

EFAMA has concerns regarding the risk that any portfolio management for clients of third countries might relocate to non- participating countries. According to Article 3 of the FTT proposal the 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. Portfolio managers located within the FTT zone would be obligated to impose an undue charge of tax to foreign clients from non-participating Member States which

would significantly reduce the performance of the portfolio. Again, that would seriously affect tax income from the FTT and would be very harmful for the fund industry of the 10 participating Member States.

## **VII. Tax rate**

In EFAMA's opinion tax rates should be related to the risk free interest rate in financial markets, which means that the FTT tax rate should be linked to overall interest rate levels. FTT rates should not exceed a very small proportion of the current risk free interest rate. Otherwise the market liquidity could instantly vanish given the fact that the capacity to buy and sell is essential. In the current short term negative interest tax environment any tax rate will have a huge impact on the costs for investors.

Furthermore, it is essential that identical FTT rates are applied in the 10 participating Member States. Deviating rates could result in competitive distortion among the Member States of the enhanced cooperation and they would unnecessarily increase compliance costs for financial institutions who have to charge or administer the FTT.

## **VIII. Increased systemic risk**

EFAMA has concerns that the proposed FTT discourages the use of securities collateral to mitigate risk. As the FTT proposal does not provide an exemption for pure hedging operations it creates an incentive to take more risks or leave certain risks unhedged, or hedge those risks at higher prices, thus increasing costs for clients. To EFAMA this seems to be contradictory to the aims of the FTT.

## **IX. Market Making Activities**

EFAMA noticed that according to the latest FTT proposal Member States may apply a rate which equals 80% of the rate they apply to financial transactions in respect of the FTT payable by a market maker. However, this reduced rate is limited to the FTT due at the side of transactions of the market maker. Even if the tax rate on market makers is reduced EFAMA has concerns that the FTT could strongly affect market making activities in the participating countries. As especially the price of small cap shares on the markets of the participating Member States is depending on the market makers this could harm every kind of investor and the CMU as a whole.

In addition, also market making activities are influenced by the non-exemption of hedging operations as described under "VIII.". When determining the prices, market makers hedge their positions. After that, they are searching for counterparties which are willing to take the deal (which may require several partial or successive transaction). Afterwards the position will be unhedged. In most cases there is a minimum of four transactions for one deal. EFAMA highly welcomes the attempt of avoidance of "cascading effects" by the introduction of Article 10 No. 2. However, in scenarios like this the FTT would still be amplified. The proposed FTT does not seem to recognize the important role of intermediation. It could therefore significantly reduce capital market liquidity.

## **X. Tax collection / Joint and several liability**

EFAMA is concerned that the proposal does not foresee comprehensive rules on tax collection and enforcement which is expected to create uncertainty and may not be resolved at the level of the participating Member States. To underline this concern we would like to provide two examples:

Firstly, the rules of the proposal are not completely clear regarding who is actually liable for paying the due taxes. According to Article 10 FTT shall be payable by each financial institution which fulfils the listed conditions. However, according to Article 2 Section 8 (e) and (g) UCITS / AIFs **and** their management companies are financial institutions in the sense of the present proposal. In cases where the fund itself is a legal person and both, the management company as well as the fund are established in the territory of a participating Member State it is not clear which financial institution needs to pay the FTT. This could lead to deviating interpretations among Member States and again to a double taxation issue.

Secondly, in particular the extraterritorial impact of certain ambiguous provisions may factually cause that financial institutions of non-participating Member States may not collect due tax. The joint and several liability approach puts an unjustified burden on in particular fully compliant financial institutions of participating Member States which have to compensate for a tax shortfall which they factually may not be able to recover.

We are grateful in advance for your attention to the concerns expressed in this letter and we welcome the opportunity to discuss these with you. In case there is any additional information that we can provide, please contact EFAMA at [info@efama.org](mailto:info@efama.org) or +32 (0)2 513 39 69.

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