



Bundesministerium
der Finanzen

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Dear Commissioner,

France and Germany strongly support the creation of a global financial transaction tax. Last year, in Toronto, President Nicolas Sarkozy and Chancellor Dr. Angela Merkel called upon the members of the G20 to come to a global agreement on a financial transaction tax.

We believe the European Union should lead the global mobilization on this issue and we asked the Council Presidency to put it on the European agenda in the coming months. At the initiative of France and Germany, the European Council of 24 and 25 March 2011 stressed that the introduction of a global financial transaction tax should be explored and developed further.

Therefore, we strongly welcome your recent announcement that a legislative proposal on the implementation of a financial transaction tax would be put forward in the autumn.

We support your efforts towards the creation of a financial transaction tax and agree on the following key principles:

A global financial transaction tax would achieve the twofold objective of establishing fair burden-sharing and economic efficiency. A global financial transaction tax would guarantee that there would be a level playing field worldwide and ensure that there would be significant revenue-raising potential.

Although the Toronto G20 meeting demonstrated that a global agreement is very difficult to achieve, we strongly believe that the implementation of a financial transaction tax at the European level would be a crucial step on the path to reaching a global consensus in a way that does not affect European competitiveness.

The finalisation of the allocation of funds raised by a financial transaction tax should not be a precondition for arriving at an agreement on a financial transaction tax.

The financial transaction tax should be designed to be technically simple and should be put in place internationally or within the European Union (EU).

The tax base should be broad and cover all financial transactions related to financial instruments such as equities, bonds, currency transactions and derivatives.

A low tax rate should be considered in order to minimize the risk of distortions and circumvention.

The tax should be owed by the counterparties. The financial institutions (banks, stock exchanges, financial services providers etc.) should be responsible for the payment of the tax on behalf of the counterparties to the transactions.

We stress that difficulties in implementation should not be used as an excuse to reject the financial transaction tax.

Further steps should be taken in cooperation with the European Council and relevant EU institutions, such as the European Central Bank, to examine the legal, technical and economic aspects.

Finally, we enclose a paper outlining the design of a financial transaction tax. In line with the announcement made by Chancellor Dr. Merkel and President Sarkozy in their joint letter of 17 August 2011 to President Van Rompuy, we believe the first elements highlighted in this letter should provide a useful starting-point for further work on this matter and our services will work in close cooperation with the Commission in the coming weeks.

We are furthermore confident that your legislative proposal will provide a valuable basis upon which to continue discussions.

Yours sincerely,



Dr. Wolfgang SCHÄUBLE



François BAROIN

Preliminary outline of a financial transaction tax (FTT)

This general outline does not prejudge the final design of a financial transaction tax (FTT), which will need further technical elaboration in the coming weeks. It nevertheless highlights the main basic principles for such a tax.

A FTT with a broad base (transactions on stocks, bonds, derivatives, currencies etc.), put in place internationally or within the European Union (EU), could generate significant revenue.

The design of tax would be to minimize the risk of distortions and circumventions. The discussion on the tax rate cannot be set apart from the one on the tax base.

The tax system should in any case be as simple as possible and fully compatible with international law.

1. Transactions subject to the tax

The tax should be payable on all financial transactions (transactions in financial instruments (securities and derivatives)) and foreign-exchange transactions. Such transactions involve the purchase or sale of a financial instrument, any agreement that establishes a right or an obligation to purchase or sell a financial instrument, and any exchange of payments based on a financial instrument, good, rate, index, spreads or an event. To prevent avoidance, fictitious financial transactions should also be taxed.

The term 'financial instruments' should at least refer to all financial instruments listed in Annex 1 Section C of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145 of 30 April 2004, p.1 - MIFID -). Transactions with structured products that are not in the scope of the MIFID directive should also be taxed. Currency spot transactions as well as currency forward and options transactions should also be covered. Repurchase agreements as well as securities borrowing and lending should also be taxed, in particular when they serve the purpose of short selling.

To help preclude tax avoidance, combinations of financial instruments are to be covered by a catch-all provision, while a blanket clause will include financial instruments that come into existence in the future. The European Commission should be responsible for ensuring that a level playing field exists between Member States for "innovative" transactions.

All financial transactions should be taxed, irrespective of whether the financial instrument is traded on an organised or regulated facility (regulated markets, multilateral trading facilities,

and possible future categories of exchanges in the context of the MIFID revision). Over-the-Counter- (OTC) transactions should therefore be in the scope of a financial transactions tax.

Financial transactions within a group would be taxed.

Neither loans and deposits, nor transactions on primary equity markets, are considered as financial transactions.

In the discussion, we would have to assess the appropriateness of taxing some non-speculative financial transactions, for instance tax subscriptions and redemptions of shares and units of investment funds, market-making activities or transactions on listed equity (private equity).

2. Territorial coverage of the tax

Financial transactions should be taxed when at least one counterparty is located in the EU. Further work is needed to define precisely the territoriality criteria, in particular regarding groups (subsidiaries and branches). To avoid as distortions and tax avoidance to the greatest extent possible, the territorial coverage should be as broad as legally permissible.

3. Tax bases

The tax base should essentially reflect the value of the individual financial transaction. Different tax bases should therefore be considered for different financial instruments, particularly derivatives.

Different options have to be considered:

- Taxing the monetary transfers that would stem from the contract as individual transactions. This method is objective since it is based on real transfers of money. Yet such a base would not be practicable for swaps and forwards, as they do not require a premium to be paid at the conclusion of the contract. Regarding options and credit default swaps (CDS), this option would be practical. The question of whether this would alleviate the tax burden on more speculative transactions would need to be examined (for instance, regarding *out of the money* options, CDS on issuers that are generally considered to be highly solvent);
- Mark to model approaches to comprehend the market value could also be thought about. For example, the value to be used in the case of interest rate derivatives can be established using the basis point value on the contract date. The basis point value accurately reflects the risk to be covered on the exact date in question. Regarding this option, concerns include the risk of a reduced taxation of the more speculative transactions and difficulties to control the valuation models of market participants;

- Taxing the notional value of the contract (value of the underlying nominal that is used to calculate payments made on a given derivative agreement). Such an option would allow taxation at the time the contract is concluded. Whether this would reduce tax on more speculative transactions would need to be examined. In any case, such a tax base would have to be technically adjusted in order to avoid manipulations;
- Using other proxy tax bases. This could be established as a function of the notional value, for instance.

For derivatives, further work is needed to determine the appropriate tax base. These financial instruments are contracts which may result in different individual financial transactions (e.g. a swap option, a future), whose value is not necessarily known at the time the contract is concluded. In many cases, there is no payment at this time (swaps) and the payments arising during the contract life are highly uncertain and volatile. Any complex derivatives contract should be broken down into elementary transactions¹. (As a preliminary thought, where the transaction price is not known until some time after the contract has been entered into (swaps, forwards), some function of the notional value should be retained.)

Further work should be devoted to repurchase agreements and securities borrowing and lending.

4. Tax Rate

The discussion on the tax rate cannot be set apart from the one on the tax base.

The possibility of adjusting the tax rate depending on the nature of the selected tax base should be considered. Different tax bases would be accompanied by different tax rates to minimize any distortionary effects. For instance, where transactions on certain derivative markets were taxed at their notional value, the tax rate would be reduced compared to transactions on spot markets, for the sake of proportionality.

The tax rate should be set as low as possible to minimise evasive reactions.

5. Persons liable for the tax

The tax should be owed by the counterparties of the financial product (the seller and the buyer will be jointly and severally liable together, subject to the principle of territoriality).

The tax burden should be shared equally between EU resident counterparties.

¹ For instance a swap option would be considered first as an option (the premium would be taxed) and then, if exercised, as a swap (whose notional value would then be taxed).

When one of the transaction counterparties is not located in the EU, the party established in the EU should be responsible for the payment of the whole amount. However, EU residents should be authorised to pay only half the tax rate on transactions with counterparties from third countries that also impose an FTT, subject to a fiscal cooperation agreement.

The exemption of some specific (public-like) financial counterparties, such as central banks, national DMOs, guarantee funds or the EFSF, could also be envisaged.

6. Collection

Financial institutions should be responsible for the collection of the tax on behalf of the transaction parties. Two options may be contemplated. Accordingly, the following could be held responsible for the tax collection:

- Intermediaries (banks, brokers, dealers) or the counterparties themselves where transactions are not concluded with EU intermediaries.
- Infrastructures (exchanges, multilateral trading facilities, central counterparties, central depositories). Central counterparties (CCPs) might be the best infrastructure to collect the tax in the case of cleared transactions. Although many OTC transactions are not centrally cleared at present, further regulation of OTC markets would lead to significant improvement in the collection of the tax. For non-cleared transactions, intermediaries would have to collect the tax anyway.

7. Taxable event

The tax should become chargeable when the counterparties enter into the transaction (accrual rule) even in the case of transactions that should be taxed on their effective transfer value. The three main advantages of this methodology would be the following:

- It would prevent taxpayers from postponing the tax liability by delaying the payment of the transaction.
- It would allow for higher revenues upfront. The tax would be charged and collected at one time, even if the transaction involved multiple payments over time (e.g., swaps and other types of derivatives).
- It would allow for the taxation of intraday and high frequency transactions that do not result in delivery/settlement.

This method is also consistent with the general principle of taxing notional values for some derivatives (swaps) since the amount of money that would change hands during the contract would not be known when the counterparties entered into the transaction.

If a transaction were subsequently reversed or cancelled, the tax on the original transaction would remain unaffected.