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IN THE COURT OF JUSTICE OF THE EUROPEAN UNION

THE UNITED KINGDOM OF GREAT BRITAIN
AND NORTHERN IRELAND

Applicant

-v-

THE COUNCIL OF THE EUROPEAN UNION

Defendant

APPLICATION FOR THE ANNULMENT OF COUNCIL DECISION 2013/52/EU OF 22 JANUARY 2013 AUTHORISING ENHANCED COOPERATION IN THE AREA OF FINANCIAL TRANSACTION TAX

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A: INTRODUCTION

1. This is an application under Article 263 TFEU to annul Council Decision 2013/52/EU authorising enhanced cooperation in the area of financial transaction tax[1] ("the Authorising Decision"). **[Annex A1]**

2. Enhanced cooperation is governed by Article 20 TEU and Articles 326 to 334 TFEU.

3. A brief account of the relevant facts is set out in the preamble to the Authorising Decision. In short:

   a. On 28 September 2011, the Commission adopted a proposal for a Council Directive on a common system of financial transaction tax[2] ("the 2011 Proposal"). **[Annex A2]** The 2011 Proposal was for an EU Directive under Article 113 TFEU, to be addressed to, and binding upon, all of the Member States of the European Union. Article 113 empowers the Council, acting unanimously, to adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation.

   b. Over the course of three Council meetings (on 22 June 2012, 29 June 2012 and 10 July 2012), it became apparent that there was no unanimous support for a common system of financial transaction tax ("FTT").

   c. By letters received between 28 September 2012 and 23 October 2012, eleven Member States – Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "Participating States") – addressed requests to the Commission indicating that they wished to establish enhanced cooperation between themselves in the area of FTT.

   d. On 25 October 2012, the Commission adopted a proposal for a Council Decision authorising enhanced cooperation in the area of FTT. **[Annex A3]**[3]

   e. On 22 January 2013, the Council adopted the Authorising Decision. Article 1 authorised the Participating States:

[1] OJ 2013 L 22, p.11.

[2] COM(2011) 594 final.

[3] COM(2012) 631 final.

"to establish enhanced cooperation between themselves in the area of the establishment of a common system of financial transaction tax, by applying the relevant provisions of the Treaties."

f. On 14 February 2013, the Commission adopted a proposal for a Council Directive implementing enhanced cooperation in the area of FTT ("the 2013 Proposal"). [4] **[Annex A4]**

B: OUTLINE OF GROUNDS OF CHALLENGE

4. The United Kingdom submits that the Authorising Decision is unlawful because it authorises the adoption of an FTT with extraterritorial effects which is contrary to Article 327 TFEU and/or customary international law.

5. Further or alternatively, the Authorising Decision is unlawful because it authorises the adoption of an FTT which will impose costs on Non-Participating States in breach of Article 332 TFEU.

C: PREMATURITY

6. The United Kingdom recognises that it may be argued that this application for annulment is premature and that, rather than challenging the Authorising Decision, the United Kingdom should challenge the measure ultimately adopted by the Participating States (the "Implementing Measure").[5] However, given the fundamental importance of the issues raised in this application, the United Kingdom cannot take the risk, however small, that, if it does not challenge the Authorising Decision, it might be said to be out of time subsequently to challenge the Implementing Measure.

7. In order to demonstrate the magnitude of the practical issues in play, by way of example:

   a. The Explanatory Memorandum to the 2013 Proposal indicates that the expected revenues of the FTT are around 31 billion Euros annually.[6] The very

[4] COM(2013) 71 final.

[5] See Joined Cases C-274/11 and C-295/11 *Spain and Italy v Council*, judgment of 16 April 2013, paras 75-78, cf. paras 81-83.

[6] See para 4, p. 14, of the Explanatory Memorandum.

significant scale of this is underscored by the fact that the entire EU budget for 2012 was 129.1 million Euros.[7]

b. The UK will be significantly and directly affected by the FTT, for example[8]:

   i. The daily European turnover in interest rate swaps – the main over-the-counter derivatives market – is $1,659bn[9], of which the UK accounts for almost 75%. It has been estimated that over 30% of trading in the UK in over-the-counter derivatives involves a counterparty in the FTT area.[10]

   ii. External research suggests that the UK government's annual borrowing costs could rise by £4bn as a result of the FTT.[11]

8. Pursuant to Article 53(2) of the Rules of Procedure, the Court has the power to dispose of an action which is manifestly inadmissible by reasoned order. Should the Court take the view that the present application is manifestly inadmissible on the grounds of prematurity, the United Kingdom would be content for the adoption of such an order disposing of this application. This would give the United Kingdom the legal certainty that it needs, clearing the way for it to challenge the Implementing Measure, whilst minimising the expenditure of resources and costs (by all the parties and the Court).

D: EXTRATERRITORIAL SCOPE OF THE AUTHORISING DECISION

9. The Authorising Decision was intended to authorise, and has been understood to have authorised, adoption of an FTT with extraterritorial scope.

10. **Counterparty principle** Article 3 of the 2011 Proposal provided:

[7] http://ec.europa.eu/budget/figures/2012/2012_en.cfm **[Annex A5]**

[8] As well as the specific examples given in this paragraph, the UK believes that the FTT will entail widespread adverse impacts on a range of UK financial businesses, including exchanges, brokers, pension funds, banks and corporate treasuries.

[9] The Impact of the Proposed European Union (EU) Financial Transaction Tax (FTT) on Derivatives, ISDA 18 January 2013 (see in particular page 8 and Tables 1 and 2) **[Annex A6]**

[10] Financial Transaction Tax: an ICAP discussion Document, ICAP April 2013 (see page 9) http://www.icap.com/~/media/B5EC97C3015B4A3C8657E057151646CA.ashx **[Annex A7]**

[11] The Impact of a Financial Transaction Tax on Corporate and Sovereign Debt, London Economics April 2013 (see pages 2 and 15) http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/research-2013/Impact-of-FTT-on-corporate-and-sovereign-debt-Final-PDF.pdf **[Annex A8]**

> "1. For the purposes of this Directive, a financial institution shall be deemed to be established in the territory of a Member State where any of the following conditions is fulfilled:
>
> (a) it has been authorised by the authorities of that Member State to act as such, in respect of transactions covered by that authorisation;
>
> (b) it has its registered seat within that Member State;
>
> (c) its permanent address or usual residence is located in that Member State;
>
> (d) it has a branch within that Member State, in respect of transactions carried out by that branch;
>
> ***(e) it is party, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction, to a financial transaction with another financial institution established in that Member State pursuant to points (a), (b), (c) or (d), or with a party established in the territory of that Member State and which is not a financial institution.***
>
> 2. Where more than one of the conditions in the list set out in paragraph 1 is fulfilled, the first condition met from the start of the list in descending order shall be relevant for determining the Member State of establishment.
>
> 3. Notwithstanding paragraph 1, a financial institution shall not be considered established within the meaning of that paragraph, in case the person liable for payment of FTT proves that there is no link between the economic substance of the transaction and the territory of any Member State.
>
> 4. A person which is not a financial institution shall be deemed to be established within a Member State if its registered seat or, in case of a natural person, if its permanent address or usual residence is located in that State, or it has a branch in that State, in respect of financial transactions carried out by that branch." (Emphasis added.)

11. The effect of Article 3(1)(e) of the 2011 Proposal is to render a counterparty to a transaction with a financial institution or party established in the territory of a Participating Member State liable for FTT, even where the counterparty:

    a. is not authorised by the authorities of a Participating State;

    b. does not have its registered seat in a Participating State;

    c. does not have its permanent address or usual residence located in a Participating State; and

    d. does not have a branch in a Participating State

    This may be termed the "Counterparty Principle".

12. Recital (6) in the preamble to the Authorising Decision, records that, in their request to the Commission to establish enhanced cooperation, the Participating States:

> "requested that the scope and objectives of the enhanced cooperation be based on the Commission proposal for a Directive of 28 September 2011".

13. They were therefore requesting, and were granted, authorisation to establish an enhanced cooperation FTT with extraterritorial effect.

14. **Issuance principle** Furthermore, the Commission has understood the Authorising Decision as permitting the adoption of an enhanced cooperation FTT with extraterritorial effect. As well as maintaining the Counterparty Principle, Article 4 of the Commission's 2013 Proposal provides:

> "1. For the purposes of this Directive, a financial institution shall be deemed to be established in the territory of a Member State where any of the following conditions is fulfilled:
>
> (a) it has been authorised by the authorities of that Member State to act as such, in respect of transactions covered by that authorisation;
>
> (b) it is authorised or otherwise entitled to operate, from abroad, as [a] financial institution in regard to the territory of that Member State, in respect of transactions covered by such authorisation or entitlement;
>
> (c) it has its registered seat within that Member State;
>
> (d) its permanent address or, if no permanent address can be ascertained, its usual residence is located in that Member State;
>
> (e) it has a branch within that Member State, in respect of transactions carried out by that branch;
>
> (f) it is party, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction, to a financial transaction with another financial institution established in that Member State pursuant to points (a), (b), (c), (d) or (e), or with a party established in the territory of that Member State and which is not a financial institution;
>
> ***(g) it is party, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction, to a financial transaction in a structured product or one of the financial instruments referred to in Section C of Annex I of Directive 2004/39/EC issued within the territory of that Member State, with the exception of instruments referred to in points (4) to (10) of that Section which are not traded on an organised platform.***

2. A person which is not a financial institution shall be deemed to be established within a participating Member State where any of the following conditions is fulfilled:

(a) its registered seat or, in case of a natural person, its permanent address or, if no permanent address can be ascertained, its usual residence is located in that State;

(b) it has a branch in that State, in respect of financial transactions carried out by that branch;

(c) it is party to a financial transaction in a structured product or one of the financial instruments referred to Section C of Annex I to Directive 2004/39/EC issued within the territory of that Member State, with the exception of instruments referred to in points (4) to (10) of that Section which are not traded on an organised platform.

3. Notwithstanding paragraphs 1 and 2, a financial institution or a person which is not a financial institution shall not be deemed to be established within the meaning of those paragraphs, where the person liable for payment of FTT proves that there is no link between the economic substance of the transaction and the territory of any Member State.

4. Where more than one of the conditions in the lists set out in paragraphs 1 and 2 respectively is fulfilled, the first condition fulfilled from the start of the list in descending order shall be relevant for determining the participating Member State of establishment." (Emphasis added.)

15. The effect of Articles 4(1)(g) and 4(2)(c) of the 2013 Proposal is to render a party to a financial transaction in respect of certain products or instruments liable for FTT solely on the basis that the relevant product or instrument, or securities underlying the product or instrument, were issued within the territory of a Participating State, even where that party:

a. is not authorised by the authorities of a Participating State;

b. does not have its registered seat in a Participating State;

c. does not have its permanent address or usual residence located in a Participating State; and

d. does not have a branch in a Participating State.

This may be termed the "Issuance Principle".

E: FIRST GROUND OF CHALLENGE - ARTICLE 327 TFEU

16. The United Kingdom submits that the Authorising Decision is contrary to Article 327 TFEU because it authorises the adoption of an FTT with extraterritorial effects which will fail to respect the competences, rights and obligations of the Non-Participating States.

17. The first sentence of Article 327 TFEU provides:

> "Any enhanced cooperation shall respect the competences, rights and obligations of those Member States which do not participate in it."

18. The sovereignty of each Member State in respect of taxation is given special protection by the Treaties. Fiscal provisions are expressly excluded by Article 114(2) TFEU from the scope of the general power under Article 114(1) to adopt measures for the approximation of laws for the purpose of establishing and ensuring the functioning of the internal market. Instead, harmonisation of fiscal provisions is the subject of a specific Treaty article, Article 113 TFEU, which provides:

> "The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition."

19. In the present case, as recognised in the preamble to the Authorising Decision, there was no unanimous support amongst the twenty-seven Member States for the adoption of an FTT at EU level. That is why the eleven Participating States sought authorisation for enhanced cooperation.

20. In such circumstances, where the FTT authorised to be adopted by enhanced cooperation may impose liability on parties who are not resident in any Participating State in respect of products or instruments which are not present in any Participating State as a result of transactions which take place outside any Participating State, such authorisation clearly fails to respect the competences, rights and obligations of the Non-Participating States, who chose not to support the adoption of such an FTT at EU level. Alternatively, the interference of such an FTT with the competences, rights and obligations of the Non-Participating States is manifestly disproportionate.

21. Recital (14) in the preamble to the Authorising Decision asserts that enhanced cooperation in respect of an FTT is in accordance with Article 327 TFEU because, "Such system would not affect the possibility for non-participating Member States to keep or introduce an FTT on the basis of non-harmonised national rules." This misses the fundamental point that the Authorising Decision has authorised an FTT which would interfere with the ability of Non-Participating States to decide that parties or transactions on their territory should ***not*** be subject to an FTT.

F: SECOND GROUND OF CHALLENGE - CUSTOMARY INTERNATIONAL LAW

(a) Customary international law is an available ground of challenge

22. Article 3(5) TEU provides that the EU shall contribute to the strict observance and development of international law.

23. In addition, the first sentence of Article 327 TFEU provides:

> "Any enhanced cooperation shall respect the competences, rights and obligations of those Member States which do not participate in it."

24. The United Kingdom submits that Article 327 TFEU therefore requires that any enhanced cooperation must respect the competences of the Non-Participating States under customary international law.

25. In Case C-366/10 *Air Transport Association of America ("ATAA")*, judgment of 21 December 2011, the Court recognised the following principles:

   a. When the European Union adopts an act, it is bound to observe international law in its entirety, including customary international law, which is binding upon the institutions of the European Union (see para 101).

   b. Principles of customary international law may be relied upon by a Member State for the purpose of the Court's examination of the validity of an act of the European Union in so far as those principles call into question the competence of the European Union to adopt that act (see para 107). In the present case, as indicated below, the relevant international law principles concern the sovereignty and legislative competence of States and therefore are clearly capable of being relied upon by the United Kingdom to challenge the extraterritorial scope of the Authorising Decision.

c. Judicial review of compliance with customary international law requires the Court to determine whether, in adopting the act in question, the relevant EU institution made a manifest error of assessment concerning the conditions for applying those principles (see para 110).

(b) Relevant principles of customary international law

(i) Sovereignty/Jurisdiction

26. The principle of sovereignty both defines and limits a State's power. In the *Island of Palmas case (Netherlands/USA)*[12], the Arbitrator made the following general remarks on sovereignty in its relation to territory:

> "Sovereignty in the relations between States signifies independence. Independence in regard to a portion of the globe is the right to exercise therein, ***to the exclusion of any other State***, the functions of a State. The development of the national organisation of States during the last few centuries and, as a corollary, the development of international law, have established this principle of the ***exclusive competence of the State in regard to its own territory*** in such a way as to make it the point of departure in settling most questions that concern international relations." (Emphasis added.)

27. It is well-established that the principle of sovereignty includes the exclusive competence of a State to ***adopt*** legislation to regulate conduct which occurs on its own territory; not just to enforce such legislation.

28. *Oppenheim's International Law* states:[13]

> a. "State jurisdiction concerns essentially the extent of each state's right ***to regulate*** conduct or the consequences of events. In practice jurisdiction is not a single concept. ***A state's jurisdiction may take various forms. Thus a state may regulate conduct by legislation***; or it may, through its courts, regulate those differences which come before them, whether arising out of the civil or criminal law; or it may regulate conduct by taking executive or administrative action which impinges more directly on the course of events, as by enforcing its laws or the decisions of its courts. The extent of a state's jurisdiction may differ in each of these contexts." (Emphasis added.)
>
> b. "Jurisdiction concerns both international law and the internal law of each state. ***The former determines the permissible limits of a state's jurisdiction*** in the

[12] 4 April 1928, Reports of International Arbitral Awards, Volume II pp.829-871. **[Annex A9]**

[13] Jennings and Watts, *Oppenheim's International Law* (9th ed, Longman), at p.456. **[Annex A10]**

various forms it may take, while the latter prescribes the extent to which, and manner in which, the state in fact asserts its jurisdiction."[14] (Emphasis added.)

29. Similarly, Vaughan Lowe and Christopher Staker[15] describe the position as follows:

   a. "Each State has the right to regulate its own public order, and to that end it is entitled to legislate for everyone within its territory. But States are also entitled to legislate for their nationals, and some actions extend over national boundaries; and there are accordingly situations in which two or more States may seek to apply their laws to the same conduct".[16]

   b. " 'Jurisdiction' is the term that describes the limits of the legal competence of a State or other regulatory authority (such as the European Community) to make, apply, and enforce rules of conduct upon persons. It 'concerns essentially the extent of each state's right to regulate conduct or the consequences of events'." [17]

   c. "The legal rules and principles governing jurisdiction have a fundamental importance in international relations, because they are concerned with the allocation between States, and other entities such as the European Union, of competence to regulate daily life – that is, the competence to secure the *differences* that make each State a distinct society. Inasmuch as they determine the reach of a State's laws, they may be said to determine what the boundaries of that State's particular public order are." [18]

(ii) Power to legislate with extraterritorial effect

30. In Case C-366/10 *ATAA*, Advocate-General Kokott summarised the basis upon which a State may legislate with extraterritorial effect as follows:[19]

"The decisive element from an international perspective is that the particular facts display a sufficient link with the State or international organisation concerned. The particular connecting factor can be based on the territoriality principle, the personality principle or – more rarely – on the universality principle."

31. *Oppenheim's International Law* states the following[20]:

"Jurisdiction is not coextensive with state sovereignty, although the relationship between them is close: a state's 'title to exercise jurisdiction rests in its sovereignty'. That jurisdiction is based on sovereignty does not mean that each state has in international law a sovereign right to exercise jurisdiction in whatever circumstances it chooses...Although it is usual to consider the exercise of jurisdiction under one or

[14] At p.456.

[15] Chapter 11 on "Jurisdiction" in *International Law*, (3rd ed, 2010), edited by Professor Malcolm D. Evans. Professor Vaughan Lowe QC is the Emeritus Chichele Professor of Public International Law and a Fellow of All Souls College in the University of Oxford. **[Annex A11]**

[16] At page 313.

[17] At page 313.

[18] At page 314.

[19] At para 149 of her Opinion.

[20] At pages 457-458.

other of more or less widely accepted categories, this is more a matter of convenience than of substance. There is, however, some tendency now to regard these various categories as parts of a single broad principle according to which the right to exercise jurisdiction depends on there being between the subject matter and the state exercising jurisdiction a sufficiently close connection to justify that state in regulating the matter and perhaps also to override any competing rights of other states."

32. Vaughan Lowe and Staker confirm the position as follows:

   a. "The sovereign equality of States is equally a fundamental principle of international law. Claims by one State to prescribe rules for persons in another State encroach upon the right of the State where those persons are based to exercise jurisdiction itself over those persons within its territory."[21]

   b. "The best view is that it is necessary for there to be some clear connecting factor, of a kind whose use is approved by international law, between the legislating State and the conduct that it seeks to regulate. This notion of the need for a linking point, which has been adopted by some prominent jurists, accords closely with the actual practice of States. If there exists such a linking point, one may presume that the State is entitled to legislate; if there does not, the State must show why it is entitled to legislate for anyone other than persons in its territory and for its nationals abroad (who are covered by the territorial and the national principles respectively)."[22]

   c. "There are two of these linking points, or 'Bases of Jurisdiction', or 'principles of jurisdiction' (the terms mean the same thing) that are firmly established in international law: territoriality, and nationality."[23]

(iii) International tax law

33. The limits which customary international law imposes on a State's entitlement to legislate with extraterritorial effect apply in relation to taxation.

34. In 1964, Dr. F. A. Mann wrote:[24]

"The existence of any principles of customary international law limiting fiscal jurisdiction has, it is true, been denied altogether.... Yet the truth is that from a relatively early day States have, on the whole, observed the implications of the familiar principle of territoriality. At the same time it is in the field of taxation that the necessity for a flexible approach was propounded with special emphasis. Already in 1892 a German economist, Georg von Schanz, developed the theory that the right of taxation depended on "wirtschaftliche Zugehörigkeit", or "economic allegiance" The idea of "allégeance économique" was taken up and developed by Allix who, however, limited its scope by attributing three elements to it, viz. domicile or

[21] Vaughan Lowe and Staker in Evans, *International Law*, above: at page 319.

[22] At page 320.

[23] At page 320.

[24] Dr. F.A. Mann, "The Doctrine of Jurisdiction in International Law", (1964) 111 Recueil des Cours pp.109-119, at p.109-111. **[Annex A12]**

residence, property, and economic activity within the taxing country. Although the terminology is not always the same, this principle is now widely accepted. It is supported by similar and highly significant trends in the cognate field of constitutional law. Thus an Australian State which in relation to the Commonwealth of Australia is a subordinate legislature exceeds its fiscal jurisdiction if its tax legislation "has no relevant territorial connection whatever with" the State, if there is no "relevant nexus" between the taxed property and the State. Or, as the Supreme Court of the United States has said, "visible territorial boundaries do not always establish the limits of a State's taxing power or jurisdiction", but due process (which, let it be repeated, does not essentially differ from such reasonableness as excludes arbitrariness or abuse of rights and is, therefore, demanded by international law) "requires some definite link, some minimum connection between a State and the person, property or transaction it seeks to tax". It is submitted that such tests provide a useful guide to the analogous problem of international fiscal jurisdiction, for it is subordination that characterises both the national legislature in relation to the international order and a state legislature in relation to the federation."

35. Dr. F.A.Mann revisited the issue in 1984 in a further paper[25] in which he referred to a 1983 judgment of the German Constitutional Court. Dr F.A.Mann set out the relevant part of the German Constitutional Court's judgment as follows:[26]

> "The imposition of taxes upon a foreigner living abroad, which is founded upon a set of facts wholly or partly implemented abroad, requires sufficient appropriate points of contact for taxation by the taxing State to prevent interference, contrary to public international law, with the foreign State's claims to sovereignty. These points of contact and their factual closeness must, from the point of public international law, satisfy a minimum reasonableness.
>
> This requirement constitutes an essential legal limitation of the sets of facts which according to the rules of its own legal system a State may lawfully lay hold of, i.e., a restriction of its international legislative jurisdiction. The legal possibility of imposing taxes upon foreigners is subject to clear limits by the necessity of contact, for instance, with nationality, establishment, residence or sojourn, the realisation of a set of taxable facts or the achievement of a legally relevant result within the State."

36. Dr F.A.Mann stated:

> "In each case the overriding question is: does there exist a sufficiently close legal connection to justify, or make it reasonable for, a State to exercise legislative jurisdiction?"

37. The US Restatement on the Foreign Relations of the United States[27] also confirms that international law imposes limits on a State's powers to impose taxes:

[25] Dr. F.A. Mann, "The Doctrine of International Jurisdiction Revisited after Twenty Years", (1984) Recueil des Cours, pp.28-30. **[Annex A13]**

[26] BVerfGE 63, 343 at page 369 (decision of the 22nd March 1983).

[27] American Law Institute, Restatement of the Law: the Foreign Relations of the United States, 3rd ed., Vo. 1 (1987) pp.258-266. **[Annex A14]**

"*Unreasonable exercise of jurisdiction to tax*. Jurisdiction to tax seldom raises issues between states, but ***an unreasonable exercise of jurisdiction to tax***, for instance a tax on a resident alien temporarily present within a state, measured by his world-wide income, ***could be challenged as a violation of international law*** by both the taxpayer and the state of the taxpayer's nationality."

(iv) Sufficiently close connections recognised by international law

38. **Territoriality/personality** As recognised by Advocate-General Kokott in *ATAA*, the two most widely recognised grounds of jurisdiction are the territoriality and personality principles.[28]

39. Territoriality is a well-recognised basis of jurisdiction as much for taxation as for other areas of legislative competence. This gives rise to an *in rem* basis of jurisdiction. Thus, a State may tax income arising in its territory, assets situated in its territory, transactions that take place in its territory, and, in the case of consumption taxes such as Value Added Tax ("VAT") and Goods and Services Tax ("GST"), consumption that takes place in its territory.[29] Territorial jurisdiction is well-recognised by decisions of the Court.[30]

40. Jurisdiction based upon the personality principle gives rise to *in personam* jurisdiction. Under the personality principle, the most common connecting factors applied are residence or domicile: that is, an individual is generally recognised as subject to the tax jurisdiction of the state where the individual is resident, and is then taxable on the individual's worldwide income, wherever arising.[31] In the case of corporations, residence/domicile is generally determined by reference to the place of central management and control, place of effective management, place of

[28] Opinion, para 149.

[29] See, for example, Wolfgang Schön, *Persons and Territories: on the International Allocation of Taxing Rights* [2010] British Tax Review 554-562, at pp. 554-555. **[Annex A15]** Professor Schön is the Director of the Max Planck Institute in Munich. On the *destination principle* for VAT, see pages 1 to 13 of the OECD International VAT/GST Guidelines, Draft Consolidated Version (February 2013) headings 1.4 and 1.5. **[Annex A16]**

[30] See, for example, Case C-446/03 *Marks & Spencer* [2005] ECR I-10837 para. 49; *Case* C-196/04 *Cadbury Schweppes* [2006] ECR I-7995 para.56; Case C-524/05 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107 para.75; Case C-231/03 *Oy AA* [2007] ECR I-6373 para. 54. In respect of VAT, see Case C-30/89 *Commission v France* [1990] ECR I-709 paras. 16-18; Case C- 111/05 *Aktiebolaget NN* [2007] ECR I-2724, at paras.42-50.

[31] In the case of taxation, nationality of individuals is not used by most countries as a connecting factor for tax jurisdiction. The one major exception is the United States which taxes its nationals even if not resident in the US and not receiving income with its source in the US.

incorporation, place of head office, place of main business activity or the location of the seat (*siège sociale*).[32]

41. Jurisdiction to tax based upon the *in personam* connecting factor of residence is an accepted aspect of direct taxes, such as income taxes and estate duties or their equivalent. It is difficult to envisage any *in personam* tax jurisdiction being exercised with regard to indirect taxes such as VAT/GST, excises or customs duties. An individual is not liable to pay excise duty on vodka because the individual is a Russian national or a resident of Russia. Excise duty is payable because the vodka is bought in Russia (and not exported) or bought abroad and imported into Russia. These taxes are imposed on the territoriality principle alone.

42. Consumption taxes like VAT or GST normally operate on the "destination basis" under which the final burden of the tax is intended to be borne by the ultimate consumer and the tax is collected by the State where that consumption takes place. Thus, goods exported from State A are subject to a border tax adjustment on export under which any indirect taxes incurred in the production of the goods to the point of export are remitted (in the EU VAT system by zero-rating or by exemption with credit), and VAT is then charged on the importation of the product into State B where it is consumed. This is an entirely territorial-based jurisdiction where, under the destination basis, VAT is collected by the State where the consumption takes place.[33] For example, a Chinese-resident national visiting the UK bears VAT on goods and services consumed there (and may claim a VAT rebate on goods purchased and exported) and a UK-resident individual who visits Australia bears Australian GST on goods and services consumed there.

43. The FTT is not a direct tax on the profits of financial institutions, but nor is it a consumption tax on the consumers of financial instruments: there are none of the mechanisms to ensure a destination basis that one finds with regard to VAT, for example. It is best seen as a form of excise duty on specific transactions.[34]

[32] See, Professor Yoram Margalioth, *"International Taxation"* in Professor RüdigerWolfrum (ed.) The Max Planck Encyclopedia of Public International Law, Vol. IX, pages 769-783, at paras. 24-28. **[Annex A17]**

[33] OECD, International VAT/GST Guidelines, Draft Consolidated Version, February 2013, sections 1.4 and 1.5.

[34] This would still be sufficient to bring it within Article 113 TFEU, which also applies to excise duties. See the discussion of financial transaction taxes as excises in Dr. Parthasarathi Shome, *Financial Transaction Taxes* (ICRIER Working Paper 254) at page 7. **[Annex A18]** Dr. Shome was the head of the Tax Policy Division of the Fiscal Affairs Department at the International Monetary Fund.

44. However, whatever its true nature, it is apparent that the Authorising Decision was intended to, and has been understood to, authorise the adoption of an FTT with extraterritorial effects which are not justified by reference to either the territoriality or personality principles.

45. The Counterparty Principle cannot possibly be justified on either of these bases.

46. The Issuance Principle cannot be justified on the personality principle and could not be justified on the territoriality principle where there was no transfer of ownership or transaction implementing the transfer (e.g. by amendment of a register) on the territory of a Participating State.

47. The Issuance Principle has been implemented in the 2013 Proposal in a form that is so ambiguous as to be potentially void, and in a form that makes an artificial distinction between different forms of securities. Alternatively, if the 2013 proposal is construed on a literal basis, it would result in an extraterritorial effect well beyond any reasonable link recognised in international law with the taxing jurisdiction.

48. Article 4(1)(g) of the 2013 Proposal deems a financial institution to be established in the territory of a Member State if:

> "(g) it is party, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction, to a financial transaction in a structured product or one of the financial instruments referred to in Section C of Annex I of Directive 2004/39/EC issued within the territory of that Member State, with the exception of instruments referred to in points (4) to (10) of that Section which are not traded on an organised platform."

49. This draft is firstly ambiguous as to the distinction between structured products and certain financial instruments issued in the territory of that Member State. Secondly, a "financial transaction" is defined in Article 2 of the 2013 Proposal to include "the conclusion of derivative contracts". On a literal reading, this would include within the scope of the Issuance Principle the conclusion of a derivative contract over a structured product or financial instrument issued in a Member State. The tax introduced under the scope of the Authorising Decision would apply, for example, to the conclusion of a derivative contract between two financial institutions established in the United States (having no other link with the taxing jurisdictions), where the reference securities underlying the derivative contract were issued in a participating

Member State.

50. However, such a reading would bring into question the exclusion of certain derivatives not traded on an organised platform by the final part of Article 4(1)(g). It would also call into question the need for the broad anti-abuse provision in Article 14 of the 2013 Proposal (which is itself an example of a measure clearly intended to have a broad extraterritorial impact).

51. The literal reading would give rise to an extreme form of extraterritorial jurisdiction which cannot possibly be justified in international law.

52. Tellingly, the lack of justification for the Issuance Principle in international law is recognised in section 6.4.2 of the Commission Staff Working Document: Impact Assessment accompanying the 2013 Proposal,[35] which states:

> "However, while such a provision for the trading in securities should not raise any legal concerns as regards extraterritoriality (after all, this principle is already well-established international tax practice), this might not hold for applying this principle to derivatives, i.e. financial instruments that were derived from a security issued in one of the participating Member States."

53. **Other categories of extraterritorial jurisdiction** There are other potential grounds of extraterritorial jurisdiction, but not all are generally recognised and accepted, particularly in relation to fiscal matters. None of these grounds is capable of justifying the extraterritorial effects of the FTT authorised by the Authorising Decision.

54. In *ATAA*, Advocate-General Kokott referred to the **universality principle**, pursuant to which some crimes are regarded as so heinous that every State has a legitimate interest in their repression.[36] This clearly has no relevance to the imposition of a tax.

55. Under the **protective principle**, it has long been recognised that, when essential interests of the State are at stake, States need to, and will, act in order to preserve themselves. The counterfeiting of a State's currency is a typical example, as is an extraterritorial conspiracy to evade the State's immigration laws. The rationale of the protective principle is linked to the protection of essential State interests. Accordingly, while the category is not closed, the potential for its expansion is

[35] SWD(2013) 28 final, 14 February 2013. **[Annex A19]**

[36] Vaughan Lowe and Staker in Evans, *International Law*, above, p.326. **[Annex A11]**

limited.[37] Again, the protective principle has no relevance to the imposition of a tax. (This is discussed further below.)

56. There is debate as to whether a pure **effects principle** exists in customary international law, so as to permit the exercise of jurisdiction purely on the basis of economic repercussions produced in a State as a result of acts carried on outside the State. Save for the United States, no such principle appears to be accepted.[38] Although the point has been argued before the Court, the Court has not accepted the existence of any such principle.[39] This debate is particularly relevant to anti-trust matters. The United Kingdom believes that the effects doctrine has never been applied to taxation.

57. In any event, even if an effects principle did apply to taxation, it would not be apt to justify either the Counterparty or Issuance Principles.

58. There is debate as to whether a **passive personality principle** exists, pursuant to which aliens may be punished for acts abroad harmful to nationals of the forum. This has no relevance to the imposition of a tax.

59. **Sufficiently close connection** Even if it were open to a State to justify the adoption of legislation with extraterritorial effect on a basis other than any of those identified above, there is no sufficiently close connection which justifies either the Counterparty or Issuance Principle.

60. As explained above, the Counterparty Principle would render a counterparty to a transaction with a financial institution or party established in the territory of a Participating Member State liable for FTT, even where the counterparty:

    a. was not authorised by the authorities of a Participating State;

    b. did not have its registered seat in a Participating State;

[37] Vaughan Lowe and Staker in Evans, *International Law*, above, p.325. **[Annex A11]**

[38] See Vaughan Lowe and Staker in Evans, *International Law*, above, pp.323-323. **[Annex A11]**

[39] In Case 48/69 *ICI v Commission ("Dyestuffs")* [1972] ECR 619 paras 125-128 and Joined Cases 89 etc/85 *Ahlström v Commission ("Woodpulp")* [1988] ECR 5193 paras 15-18, the Court relied on the fact that implementation had taken place on the territory of the Common Market, not on an effects doctrine. Similarly, in Case T-102/96 *Gencor v Commission* [1999] ECR II-753 paras 76-111, the General Court held (at para 87) that the territorial scope of the Merger Regulation was consistent with *Woodpulp* insofar as it referred to sales within the Community.

c. did not have its permanent address or usual residence located in a Participating State; and

d. did not have a branch in a Participating State.

61. For example, a UK financial institution transacting in London in a financial instrument issued in London with the UK branch of a financial institution headquartered in Germany will be liable to pay FTT. The link between the UK financial institution and Germany is clearly insufficient, as a matter of public international law, to justify the imposition of such a tax liability with extraterritorial effect. This would be equally true of a US financial institution transacting in New York with the local branch of a financial institution headquartered in Germany.[40]

62. A similar conclusion must follow in respect of the Issuance Principle, which renders a party to a financial transaction liable for FTT solely on the basis that the relevant product or instrument was issued within the territory of a Participating State, even if there is no transfer of ownership or transaction implementing the transfer (e.g. by amendment of a register) on the territory of a Participating State. For example, two UK financial institutions transacting in London in a financial instrument issued in Germany will both be liable to pay FTT. Further, under the 2013 proposal, a UK person other than a financial institution, transacting with a UK financial institution, with the transaction taking place in London, in a financial instrument issued in Germany, will be liable to pay FTT.

63. Similarly, a US financial institution writing a derivative with a Japanese financial institution in respect of which the underlying securities were issued in France; both parties would be liable to the FTT by reference to the value of the underlying securities, even if there is no transfer of ownership or transaction implementing the transfer (e.g. by amendment of a register) on the territory of a Participating State.[41]

[40] Unlike the London example, however, the US financial institution would not be amenable to a process for recovery of the FTT through Council Directive 2010/24/EU of 16 March 2010 concerning Mutual Assistance for the Recovery of Claims relating to Taxes, Duties and other Measures. **[Annex A20]**

[41] In that situation, the FTT would in practice be irrecoverable and it is unlikely that the taxing state would even be aware of the transaction. It is very different, however, where one or both of the financial institutions is situated in a Non-Participating Member State where administrative assistance under Council Directives 2010/24/EU **[Annex A20]** and 2011/16/EU **[Annex A21]** would apply.

64. Again, this cannot be a sufficient nexus to justify the imposition of tax liability on a party that is not resident in a Participating State, is not authorised to operate in a Participating Sate and has no branch in a Participating State.

65. Furthermore, none of the objectives of the FTT identified in the preamble to the Authorising Decision could justify its extraterritorial effects.

66. First, recital (3) refers to the desire "to ensure that the financial sector fairly and substantially contributes to the costs of the crisis and that it is taxed in a fair way vis-à-vis other sectors for the future" and "to generate additional revenue for general budgets or specific policy purposes." The collection of revenue to fund government cannot justify extraterritorial imposition of tax liability. All governments need money, and it cannot be a reasonable connecting factor to impose a tax with extraterritorial effect simply because a particular taxpayer in a Non-Participating State is wealthy or a particular activity in a Non-Participating State is considered to be under-taxed. It cannot be said that because State A needs money, and the banking sector in State B is presently under-taxed, therefore State A can impose a tax on that sector.

67. Second, recital (3) refers to the desire "to disincentivise excessively risky activities by financial institutions" and "to complement regulatory measures aimed at avoiding future crises." However, seeking indirectly to regulate financial institutions in Non-Participating States by means of the imposition of tax liability on them cannot constitute a sufficiently close connection in international law. It would go far beyond the currently recognised nature and scope of the protective principle. Indeed, this aspect of the FTT instead serves to highlight the unwarranted and disproportionate nature of the intrusion in the jurisdiction of the Non-Participating State to regulate and tax financial institutions in their own territory.

68. Third, recital (6) refers to "the need to avoid evasive actions, distortions and transfers to other jurisdictions." The concern by the Participating States that the introduction of an FTT on their territories will cause the migration of financial transactions to Non-Participating States cannot justify the authorisation of an FTT with extraterritorial effect, whether under the protective principle or otherwise. The protective principle permits a State to protect itself from threats by others to its essential interests, not to protect itself from the negative effects of its own legislation.

The possibility of relocation of financial transactions is one caused by the requests for authorisation for enhanced cooperation by the Participating States themselves. In circumstances where the Non-Participating States have made deliberate choices not to adopt an FTT at EU level, the Participating States are not justified under international law in adopting an FTT with extraterritorial effect in an attempt to protect themselves from the negative consequences of their own legislative choices.

(c) Shifting the burden of proof

69. Both the 2011 and 2013 Proposals contain a provision whereby a financial institution shall not be considered established within a Participating State, in case the person liable for payment of FTT proves that there is no link between the economic substance of the transaction and the territory of any Participating State.[42]

70. Such a provision cannot cure the breach of Article 327 TFEU or customary international law. It is for a State to justify legislation with extraterritorial effects; not for individuals to prove that such effects are not justified. As Vaughan Lowe and Straker confirm:

> "State practice is consistently based upon the premiss that it is for the State asserting some novel extraterritorial jurisdiction to provide that it is entitled to do so."[43]

71. Furthermore, the concept of "no link between the economic substance of the transaction and the territory of any Participating State" is so vague as to be devoid of practical effect. It is contrary to the principle of legal certainty and therefore worthless.

(d) Conclusion

72. In light of the above, the Authorising Decision is unlawful because it authorises the adoption of an FTT with extraterritorial effects for which there is no justification in international law.

G: THIRD GROUND OF CHALLENGE - ARTICLE 332 TFEU

73. Article 332 TFEU provides:

[42] Article 3(3) of the 2011 Proposal and Article 4(3) of the 2013 Proposal.

[43] Vaughan Lowe and Staker in Evans, *International Law*, above, p.319. **[Annex A11]**

> "Expenditure resulting from implementation of enhanced cooperation, other than administrative costs entailed for the institutions, shall be borne by the participating Member States, unless all members of the Council, acting unanimously after consulting the European Parliament, decide otherwise."

74. Under Article 332, all members of the Council may therefore decide to waive the requirement that expenditure resulting from implementation of enhanced cooperation, other than administrative costs entailed for the institutions, shall be borne by the participating Member States. No such decision has been proposed or adopted.

75. In order to be lawful, the costs of implementing the FTT must therefore be borne by the Participating States. This will not be the case because implementation of the enhanced cooperation FTT will inevitably entail costs for the Non-Participating States under Council Directive 2010/24/EU concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures[44] and Council Directive 2011/16/EU on administrative cooperation in the field of taxation.[45]

76. Article 2 of both Directives provides that they apply "to all taxes of any kind levied by, or on behalf of, a Member State". They would therefore cover an FTT levied by the Participating States.

77. Directive 2010/24 imposes various obligations on the Member States, relating to exchange of information (Article 5); allowing officials from one Member State to be present in administrative offices and to participate in administrative enquiries in another Member State (Article 7); notifying documents relating to claims (Articles 8-9); recovering claims (Articles 10 to 15); and taking precautionary measures to ensure recovery (Article 16). Pursuant to Article 20(2), Member States must renounce all claims on each other for the reimbursement of costs arising from any mutual assistance they grant each other pursuant to the Directive.

78. Directive 2011/16 also imposes various obligations on the Member States, relating to exchange of information (Articles 5 to 10); allowing officials from one Member State to be present in administrative offices and to participate in administrative enquiries in another Member State (Article 11); conducting simultaneous controls (Article 12); and notifying addressees of instruments and decisions emanating from the

[44] OJ 2010 L 84, p.1. **[Annex A20]**
[45] OJ 2011 L 64, p.1. **[Annex A21]**

administrative authorities of another Member State (Article 13). Performance of these obligations will inevitably require expenditure of costs by the Non-Participating States. Under Directive 2011/16, there is no means for the Non-Participating States to seek recovery of such costs from the Participating States.

79. By way of example, fiscal authorities have wide investigatory powers authorising a thorough investigation into a financial institution's transaction records, required to be kept pursuant to Article 25(2) of Directive 2004/39/EC on markets in financial instruments,[46] in order to assess the quantity of tax due. United Kingdom authorities could therefore be requested to investigate the FTT paid by a French bank in respect of its London trading activities. Such assistance would be very onerous, requiring specialist expertise and systems. A simple sale of a security through a bourse could easily generate half a dozen taxable events due to the "cascade" effect. Such exercises would create significant administrative challenges for fiscal authorities, giving rise to significant one off costs, to build the systems and controls required to provide this type of assistance, and ongoing costs arising from individual requests for assistance.

80. It follows that the Authorising Decision breaches Article 332 TFEU because it authorises an FTT which will inevitably cause costs to be incurred by the Non-Participating States.

H: ORDER SOUGHT

81. In light of the above, the United Kingdom seeks an order:

a. annulling the Authorising Decision; and

b. requiring the Council to pay the United Kingdom's costs of these proceedings.

E. Jenkinson

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[46] OJ 2004 L 145, p.1. **[Annex A22]**

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SCHEDULE OF ANNEXES

Annex	Description	Length (pages)	Reference in Application
Contested measure			
A1	Council Decision 2013/52/EU authorising enhanced cooperation in the area of financial transaction tax ("the Authorising Decision")	2	Page 3 paras 1 and 3(e); Page 4 paras 4-5; Page 5 para 9; Page 7 paras 12 and 14; Page 9 paras 16 and 19; Page 10 para 21; Page 11 para 25(b); Page 17 paras 44 and 49 ; Page 18 para 53; Page 21 para 65; Page 22 para 72 ; Page 24 para 80.
Documents			
A2	COM (2011) 594 proposal for a Council Directive on a common system of financial transaction tax ("the 2011 Proposal")	31	Page 3 para 3(a); Page 5 para 10; Page 6 para 11; Page 22 para 69
A3	COM (2012) 631 proposal for a Council Decision authorising enhanced cooperation in the area of FTT	12	Page 3 para 3(d)
A4	COM (2013) 71 proposal for a Council Directive implementing enhanced cooperation in the area of FTT ("the 2013 Proposal)	39	Page 4 paras 3(f) and 7(a); Page 7 para 14; Page 8 para 15; Page 17 paras 47- Page 18 para 50; Page 20 para 62; Page 22 para 69
A5	EU Budget 2012 in Figures http://ec.europa.eu/budget/figures/2012/2012_en.cfm	2	Page 5 para 7(a), footnote 7
A6	The Impact of the Proposed European Financial Transaction Tax (FTT) on Derivatives, ISDA 18 January 2012	47	Page 5 para 7(b)(i), footnote 9
A7	Financial Transaction Tax: an ICAP discussion Document, ICAP April 2013	13	Page 5 para 7(b)(i), footnote 10
A8	The Impact of a Financial Transaction Tax on Corporate and Sovereign Debt, London Economics April 2013	34	Page 5 para 7(b)(ii), footnote 11
Judgment			
A9	*Island of Palmas case (Netherlands/USA)* 4 April 1928, Reports of International Arbitral Awards, Volume II pp.829-871	44	Page 11 para 26, footnote 12

Legal Writings			
A10	Jennings and Watts, *Oppenheim's International Law* (9th ed, Longman), at pp. 456-458	4	Page 11 para 28, footnote 13; Page 12 para 31
A11	Vaughan Lowe and Christopher Staker, Chapter 11 on "Jurisdiction" in *International Law*, (3rd ed, 2010), edited by Professor Malcolm D. Evans.	28	Page 12 para 29, footnote 15; Page 13 para 32; Page 19 paras 54 -56; Page 22 para 70
A12	Dr. F.A. Mann, "The Doctrine of Jurisdiction in International Law", (1964) 111 Recueil des Cours pp.109-119	12	Page 13 para 34, footnote 24
A13	Dr. F.A. Mann, "The Doctrine of International Jurisdiction Revisited after Twenty Years", (1984) Recueil des Cours, pp.28-30	4	Page 14 para 35, footnote 25 and para 36
A14	US Restatement on the Foreign Relations of the United States, American Law Institute, Restatement of the Law: the Foreign Relations of the United States, 3rd ed., Vo. 1 (1987) pp.258-266	10	Page 14 para 37, footnote 27
A15	Wolfgang Schön, *Persons and Territories: on the International Allocation of Taxing Rights* [2010] British Tax Review 554-562	7	Page 15 para 39, footnote 29
Document			
A16	OECD International VAT/GST Guidelines, Draft Consolidated Version (February 2013)	63	Page 15 para 39, footnote 29; Page 16 para 42, footnote 33
Legal Writings			
A17	Professor Yoram Margalioth, *"International Taxation"* in Professor RüdigerWolfrum (ed.) The Max Planck Encyclopedia of Public International Law, Vol. IX, pages 769-783	14	Page 16 para 40, footnote 32
A18	Dr. Parthasarathi Shome, *Financial Transaction Taxes* (ICRIER Working Paper 254)	23	Page 16, para 43, footnote 34
Document			
A19	SWD(2013) 28 final, 14 February 2013 Commission Staff Working Document: Impact Assessment accompanying the 2013 Proposal	70	Page 18, para 52, footnote 35
Legislation			
A20	Council Directive 2010/24/EU of 16 March 2010 concerning Mutual Assistance for the Recovery of Claims relating to Taxes, Duties and other Measures	12	Page 20 para 61 footnote 40 and para 63 footnote 41 ; Page 23 para 75 footnote 44
A21	Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC	12	Page 20 para 63 footnote 41; Page 23 para 75,

			footnote 45
A22	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments	88	Page 24 para 79, footnote 46.