



FX and the Financial Transaction Tax

- In February 2013, the European Commission published a detailed proposal of a Financial Transaction Tax (FTT) to be implemented based on an 'enhanced cooperation' agreement between 11 participating EU member states.
- The proposal will tax transactions in securities at 0.1% of notional value and derivatives at 0.01%. The FTT will be levied on all transactions involving financial institutions where one of the counterparties is established in a participating member state and/or where the financial instrument is issued in a participating member state.
- The FTT would have wide ranging implications for the FX industry. While FX spot transactions will not be taxed, forwards, swaps, NDFs and options may be taxed. Transactions in these products would be taxed at the rate for derivatives.
- In its current form, the FTT would dramatically increase transaction costs for FX market participants. This could result in the effective closure of the non-spot FX market in participating member states.
- The FTT would translate into substantial costs for the real economy. It would be passed on to end users of FX derivatives, reducing corporate competitiveness and acting as a tax on extra-EMU exports. The FTT would also drain liquidity from markets, impair market efficiency and widen bid-offer spreads.
- The design of the FTT may be incompatible with existing global efforts in financial reform. By discouraging forms of financial intermediation, the FTT appears to run counter to the goals of US and European legislation, which are designed to encourage greater clearing and margining of transactions in order to reduce credit risk.

The Bottom Line

On 22nd January 2013 the European Council gave the go ahead to 11 EU member states to negotiate a Financial Transaction Tax (FTT).¹ The European Commission originally proposed an EU-wide FTT in September 2011. The three stated objectives of the FTT were to avoid the fragmentation of the internal market for financial services, enhance the contribution of the financial services sector to the tax base and discourage financial transactions inconsistent with efficient market functioning.²

After EU finance ministers failed to reach unanimous agreement on the original proposal, it was decided that progress would be made through a limited group of

¹ Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, Spain

² A number of Eurozone states, including France and Italy, have already introduced financial transaction taxes at a national level. The goal of the European Commission was to harmonize these efforts and prevent an uncoordinated multi-approach system in Eurozone financial markets.