

IMPLEMENTING ENHANCED COOPERATION IN THE AREA OF FINANCIAL TRANSACTION TAX
– NON-PAPER BY DG TAXUD –
FOR CONSIDERATION AT THE COUNCIL WORKING PARTY ON TAX QUESTIONS MEETING
ON 22 MAY 2013

The purpose of this room document, which was established by DG Taxation and Customs Union ('Taxud') on the basis of the Commission proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (COM(2013) 71, hereinafter: FTT proposal) – in response to a request by 11 Member States participating in the enhanced cooperation in the FTT area (BE, DE, EE, EL, ES, FR, IT, AT, PT, SI, SK), is to provide replies to the questions submitted by those delegations as Room Document #4 of the WPTQ – FTT of 16 April 2013. This non-paper has been elaborated for facilitating discussion in the Council Working Party on Tax Questions and cannot be considered a 'legal guideline'; it is provided for purely illustrative and informative purposes and does not in any way bind the Commission of the European Union. DG Taxud accepts no responsibility or liability whatsoever with regard to the information in this document.

REPLIES TO QUESTIONS OF 11 PARTICIPATING MEMBER STATES
ADDRESSED TO THE EUROPEAN COMMISSION

Collection of the tax

- *Acts implementing collection and declaration of the tax*

Article 11, par. 1 of the Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (the Proposal) states that “the participating Member States shall lay down registration, accounting reporting obligations and other obligations intended to ensure that FTT due is effectively paid to the tax authorities”. Nevertheless, common general principles governing the collection and the declaration of the tax already included in the text of the Directive. could help facilitating: (i) the cross-border exchange of information amongst different MS or between MS and other third countries; (ii) the market operators and persons paying/ collecting the tax, by having a common system of collection and declaration in the different countries where they might have to pay/declare; (iii) the reduction of costs of implementation, as a result of the above; (iv) the implementation for both the market and the tax authorities, by having common rules and forms already defined.

Given the above, the 11 MS are also aware that the specific details regarding (for example) the methods of the collection and the tax return forms cannot be contained in the Directive.

As a consequence, the 11 MS would like to ask the Commission which acts could allow to further implement more in detail the general and common principles they would like to include in Article 11 of the Directive.

Would it be feasible to implement in more detail the general and common principles of collection and declaration of the tax in the Directive?

More specifically, which kind of legal acts and which procedure could allow them to work together on the definition of the details, forms, etc. for a common collection and declaration system?

Answer:

The obligations referred to in Article 11 of the proposal aim at ensuring the effective payment of the tax and the collection methods. They were not spelled out in detail in the proposal (COM(2013) 71 final).

However, the Commission has proposed to be empowered to specify the various obligations intended to ensure proper payment of the FTT, and to adopt implementing acts providing for uniform methods of collection. The intention was to make sure that technical details in these areas are provided for, to the extent appropriate, while maintaining adequate flexibility in case modifications are needed. Whilst the Commission remains convinced, for the reasons given, that such empowerments provide the adequate solution , it is also true that the detailed rules in the areas concerned could, legally speaking , be foreseen in the directive itself.

The following could for example be specified in the directive:

- that financial institutions (FIs) established in the FTT jurisdiction need to be identified for the purposes of the FTT Directive and when they have to use this specific ID-number. The format of this number could be also defined;
- which information is to be provided on the counterparty in a financial transaction (to define residence for the proposed FTT), on the role of financial institutions in a transaction (to define the liable person), to whom, by whom, when?;
- how to identify a person liable to pay FTT where a financial institution acts in the name or for the account of another FI (i.e. when Article 10(2) of the FTT proposal applies);
- which type of information and how FIs have to keep it for FTT purposes;
- when, how and what they have to report to the tax authorities;
- more precisely what information the FTT return has to contain, how to be filed;
- how and when the tax will be collected in practice within the FTT jurisdictions: centrally or per financial institution (and depending on the type of trade/instrument) – for instance, possible separate data keeping and reporting obligations for the central collection points,
- whether or not the tax should be charged and paid by market-infrastructure operators (where applicable),
- how the non-compliance regime should look like and how it has to be enforced.

In case of need, further details of the rules or their implementation could then – and in accordance with the Treaty rules on delegated and implementing acts - be defined through such acts.

Last, how would the use of “implementing acts” work in case of the enhanced cooperation? Which MS would participate to the committee provided for by Article 5 of the Regulation 182/2011?

Answer:

The proposal provides for delegated acts as regards obligations intended to ensure that FTT due is effectively paid to the tax authorities (Articles 11(2) and 16) and implementing acts for uniform collection methods (Articles 11(5) and 18).

Like the proposed directive itself, these acts would bind only the participating Member States.

The FTT Committee as provided for in Article 18 of the FTT proposal, which is a committee within the meaning of Article 3(2) of the EP and Council Regulation (EU) 182/2011, would be set up for the purpose of adopting Commission implementing acts (on collection methods). No other competence is specified. However, the Commission can at any time convene a working group on other specific issues where future amendments to the Directive were to be contemplated and practical implementation issues can be analysed in more depth via the various instruments of the FISCALIS programme (seminars, workshops, project groups etc.).

The FTT Committee within the meaning of Article 3(2) of Regulation (EU) 182/2011 would be composed of representatives of the participating Member States and chaired by a representative of the Commission.

However, this is without prejudice to the question whether non-participating Member States can be invited as (non-member) observers. Applying the spirit of the rules of procedure of committees to a policy implemented under enhanced cooperation could allow for creating an observer status of non-participating EU Member States (cf. on this point article 7 of the Standard rules of procedure, which foresees a participation only of third States and candidate countries, but this could be adapted in the specific cases as the authors of these Standard rules did not have a scenario of "enhanced cooperation" in mind when setting up these rules).

- *Cross-border exchange of information and recovery of the tax*

What are the Commission's plans to ensure the successful implementation of the FTT as far as non-EU member countries are concerned? In particular, what type of contacts/negotiations does the Commission believe should be established with non-EU governments/financial institutions?

For example, with regard to the exchange of information, the OECD Model has amended in year 2000 Art. 26 by including also other taxes not covered by the other articles of the treaty (*"The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind"*). Only treaties signed or amended after that date may contain the provision of exchange of information on all the taxes, but from experience of some MS very few treaties include it. Similar considerations can be made on Article 27.

With respect to the OECD-Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters, if the FTT should be considered as included in Article 2, paragraph 1.b.iii G (*"any other taxes"*), then very few countries would allow the exchange of information on FTT, and still less would grant the assistance in recovery of tax credits.

As a result, what is the Commission's view on the potential application of current double taxation treaties or other Conventions to ensure effective exchange of information/cooperation in the collection of the FTT?

Answer:

One should firstly recall that the collection of national taxes falls in the competence of the Member State levying this tax. This also holds for national FTTs. The policy initiative of establishing a common framework of FTT is not about introducing a European tax but about harmonising national taxes.

Only subsidiary to this general context, the following has to be taken into account:

- The **systematic** collection of FTT outside the FTT jurisdiction would require the support by the authorities of the States concerned, so that obligations can be imposed on the economic operators situated in those States. Bilateral agreements could be one solution or alternatively, multilateral ones.
- The exchange of information between Member States is the subject of separate EU legal instruments such as Directive 2010/24/EU¹ and Directive 2011/16/EU² that would also apply to FTT.
- The exchange of information with third countries is partly the subject of existing instruments, such as the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters (referred to above) and possibly bilateral Tax Treaties. It might be useful to establish new agreements or to extend existing ones in the framework of FTT.
- Making tax compliance a "business case" for persons liable to pay the tax (i.e. financial institutions deemed to be established in the FTT jurisdiction), e.g. with the help of the "joint and several liability" provisions of Article 10(3)-(4), would be the most promising avenue for encouraging voluntary tax compliance, as it would be in the economic interest of financial institutions to facilitate and guarantee the actual collection and payment of the tax.
- This "business case" **for financial institutions from the FTT jurisdiction** when interacting with financial institutions from non-FTT jurisdictions is enabled by the provisions of Article 10(3) and 10(4) on "joint and several liability". The same holds **for trading platforms, clearing houses, central counter parties, central securities depositories and international central securities depositories in the FTT jurisdiction**. Thus, financial institutions from countries of the FTT jurisdiction have every incentive to only interact with tax-compliant counterparties and with market-infrastructure providers (e.g. trading venues or clearing houses outside the FTT jurisdiction), be these financial institutions and market-infrastructure providers established within the FTT jurisdiction or not.

¹ Council Directive 2010/24/EU concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures (OJ 2010 L 84, p.1).

² Council Directive 2011/16/EU on administrative cooperation in the field of taxation (OJ 2011 L 64, p.1).

- Such a "business case" for tax compliance for FIs from the FTT jurisdiction would – in turn – also facilitate a "business case" for trading venues etc. in jurisdictions outside the FTT zone for as long as they want financial institutions from the FTT jurisdiction to use these infrastructures as well. However, FIs from the FTT jurisdiction might not be inclined to trade on such trading venues in case these infrastructures were not to be considered facilitating FTT compliance. (See also the reply further down on "joint and several liability" and introducing the concept of "certified" trading platform or clearing houses.)
- "Double taxation" might become an issue in any case, notably with respect to those countries (presently) outside the envisaged FTT jurisdiction that already now levy some kind of tax on financial transactions as they are hosting important financial centres themselves, such as the United Kingdom, Luxemburg, Switzerland, Hong Kong, Singapore or China.
- The systematic avoidance of occurrences of double taxation and double non-taxation would require agreements with different non-FTT jurisdictions. Such treaties should preferably also foresee some provisions on administrative cooperation, an automatic exchange of information so as to facilitate voluntary tax compliance of financial institutions also from these jurisdictions. Bilateral agreements could be one solution or alternatively, multilateral ones.

Liabile person

The definition of "Financial institution" should not lead to some distortionary effects or to some circumvention of the tax by shifting, to transactions where a financial institution is not involved.

In case of listed instruments, there may be situations in which no "financial institution" as defined in Article 2 of the Directive is involved in the transaction.

In case of non-listed instruments, in many situations no "financial institution" is involved (but mainly Notary Public, or direct transaction between the parties, etc).

How would the FTT apply in these cases?

Last, when shares are exchanged between two different entities with no intermediaries, sending the order to their depositary entity, would this transaction be taxed?

Answer:

The Commission proposed to tax only financial transactions (where at least one party to the transaction is established or deemed to be established in the territory of a participating Member State) and that a financial institution established in the territory of a participating Member State is 'involved'³ in the transaction (Article 3(1) of the FTT proposal).

Thus, in particular, when shares are exchanged between different entities with no intermediaries, sending the order to their depositary entity, such transaction would be out of the scope of the FTT if there is no involvement of a financial institution as defined in Article 2(1) point (8) of the FTT proposal.

The condition of the involvement of a financial institution in the transaction subject to FTT stems from two of the objectives of the proposal:

- ensuring that financial institutions make a fair and substantial contribution to covering the costs of the recent crisis and
- creating a level playing field with other sectors from a taxation point of view.

In view of the broad definition of "financial institution" in the FTT proposal the above definition of taxable transactions should cover most of the financial transactions envisaged by the proposal and leave little or no room for substitution of a financial institution to a non-financial.

It has never been the aim to tax transactions directly between citizens or between enterprises with a limited volume of financial transactions or between citizens and these enterprises, without any involvement of a financial institution. Moreover, the bulk of transactions is between financial institutions themselves. It is also to be noted that as far as an important part of the taxable financial instruments is concerned (shares, bonds and related securities), the scope of the proposal is limited to "transferable" securities, meaning those classes of securities which are negotiable on the capital market (MiFID – EP and Council Directive 2004/39/EC, Section C of Annex I and Article 4(1) point (18)).

However, one might want to closely monitor market developments once the directive will have been effectively applied and propose amendments, when necessary, in the context of the regular review of the directive.

³ A financial institution is involved in a financial transaction where it acts as a party to the transaction, 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.

Bonds

- *Government bonds*

The impact assessment accompanying the document Proposal (SWD(2013)28 Final) it is not fully clear on how the taxation on government bonds would interact with the cost of national debt and whether at the overall level of the 11 MS the negative effect of the increase of the cost of national debts could be counterbalanced by the revenues of the FTT.

In particular, it is not clear:

- (i) if the redistribution effect amongst the 11 MS has been considered or not by the Commission, and if yes, which are the related figures (the present scope of the Commission's proposal in terms of "territoriality" would not allow each MS to collect the whole EU FTT paid on the bonds issued by the same MS. As a result, the increase of cost of government debt which one MS would bear due to the application of the EU FTT would not necessarily be compensated by the collection of the tax on the same instruments. In the "impact assessment" accompanying the Proposal the Commission affirms that "for each euro potentially to be spent on higher interest rates governments would receive more than three euro in return in form of higher FTT revenue (gross revenue)".

Could the Commission detail such analysis? Could the Commission explain in particular the redistributive effect of revenues amongst participating MS deriving from the specific "territorial" principle contained in the Proposal?

Answer:

As explained in the impact assessment accompanying the proposal of 2013, the Commission could not come up with estimations on the regional breakdown of revenues, neither for overall revenues nor for revenues broken down by product. Estimating such a regional breakdown would have required information presently not at the disposal of Commission services, such as information on the place of establishment of the financial institutions interacting with each other on the different products and the different market places and in over-the-counter transactions. Member States might be better placed to have access to such information.

In the light of the above, and following the discussions and the consensus at the Council WPTQ meeting of 16 April 2013, the Commission is preparing a questionnaire to be sent to all Member States in order to gather information directly from Member States on both the gross value (before netting and settlement) and the net value of financial transactions with *inter alia* government bonds carried out during the last full calendar year broken down according to the type of market (primary or secondary) and the location of the parties (domestic, from the participating Member States, from non-participating Member States or from third countries).

Under the ranking of criteria of the residence principle as laid down in Article 4(1) of the draft directive, it would mainly be relevant for the territorial assignment of tax revenues where the ("headquarter") authorisation of a financial institution had been given. Thus, it would first be relevant to check "who is trading with whom?", and not "what product is traded?"

In consequence, it would in first place be largely irrelevant where the securities traded had been issued. The reasoning behind this was that it were after all in first place the Member States of the headquarters of a financial institution having entered troubled waters that had to bail out parts of the financial sector industry, while also (the economies of) other Member States have largely benefited from this bailing out as well.

While one can assume that large parts of revenues collected from the trading in domestic bonds will accrue to the own treasury as typically domestic bonds are predominantly traded by domestic financial institutions, it is clear that under such a design not all revenues collected from the trading in government bonds and bills will accrue to the issuing government.

On the other side, while under the provisions as proposed by the Commission individual Member States might not receive all tax revenues levied on the trading in domestic government bonds they would instead benefit from receiving tax revenues from taxing the trading in non-domestic bonds and bills. Thus, while e.g. Germany might benefit from taxing the trading by German banks and asset managers in Italian bonds Italy might in return benefit from taxing the trading by Italian banks and asset managers in German bonds. The net effect of such territorial incidence of tax revenues would be determined by different factors, most importantly by the liquidity of markets, the attractiveness of domestic bonds for foreign investors and the level of outstanding debt. This information is presently not available to the Commission and Member States might be in a better position to monitor these parameters.

If one insisted, one possible way of achieving a complete matching of issuance and tax revenues could be if one turned the order of criteria around by making what is now in Article 4(1) point (g) the first criterion determining the power to tax, i.e. Article 4(1) point (g) became Article 4(1) point (a). In such a scenario the tax from the trading in government bonds and bills would automatically accrue to the country having issued these securities, e.g. all tax revenues from trading in Italian government bonds (by whom so ever) would then accrue to Italy while all tax revenues from trading in German government bonds (by whom so ever) would then accrue to Germany. This would then also be the case for the tax revenues on the trading in other securities, such as enterprise bonds or shares, or the trading in derivatives issued in a specific Member State.

- (i) how the figures indicated in the impact assessment are calculated; in particular, it is not clear how the Commission estimated the 2bn euro related to the mitigating effects, as well as more clarifications would be requested on the calculation of the 0.07% increase of the public budgets and on the revenues from bonds.

Can the Commission give evidence of such estimates?

Answer:

The **revenue estimations** of the impact assessment were based on the following assumptions:

- In 2012, outstanding public debt in EU11 was about EUR 8 trillion, of which EUR 5.5 trillion had been assumed to be issued in tradable bonds and bills.
- In line with the observable turnover practice of assets of pension funds specialised in investing in government securities, it was also assumed that about 2/3 to 3/4 of this (EUR 3.6 to 4.1 trillion) is traded annually.
- A reduction in market turnover by 15% is assumed at a tax rate of 0.1%, which gives an annual market turnover (after the introduction of the FTT) of EUR 3.1 to 3.5 trillion.
- Under the assumption that both the seller and the buyer were financial institutions, the accruing revenues from the trading in government bonds and bills would be EUR 6.2 to 7.0 billion for EU11. The impact assessment used as a central figure EUR 6.5 billion for EU11.

The figure of **7 basis points** was derived from the model simulations as documented in more detail in *Raciborski, Lendvai, Vogel (2012): "Securities Transaction Taxes – Macroeconomic Implications in a General-Equilibrium Model", ECFIN Economic Paper No 450*". This model simulation did not differentiate between enterprise and government securities but was simply simulating the effects of a tax on securities on the price for a security and, thus, the 'cost of capital', and derived from this effects on investment and, eventually, on growth and jobs.

The model simulations were based on the assumption that at the end of each period about 20% of all traders sell all their assets and leave the market while the new market entrants buy all these assets having been made available by the market exits. As the model is a quarterly model, this means that about 80% of all outstanding securities are traded once a year. In the impact assessment, the modelled increase of 7 basis points was then applied to the EU11 outstanding government bonds, resulting in a modelled increase in the borrowing cost of about EUR 3.85 bn.

It might be worthwhile noting in this context that the introduction of the French FTT back in August 2012 does not seem to have had a negative impact on share prices in France, thus, an increase in the 'cost of capital' as predicted by economic models does not seem to have occurred. Neither did the introduction of the tax trigger an increase in volatility of taxed shares (as compared to the volatility in the pre-tax period or as compared to other, non-taxed markets).

If one wanted to challenge the assumptions on the **turnover-frequency of public debt** and assumed significantly more liquid national markets for government bonds and bills (please note: the "trading" of government securities in the context of RePo markets does not enter in this equation here as zero revenues were assumed from taxing these RePos and as it was assumed that RePos would be based on pledging the collateral instead of purchasing/selling it) one would have to calculate with both correspondingly higher cost of borrowing and correspondingly higher tax revenues. In such a scenario, one could achieve the same tax revenues (and be exposed to the same increase in the cost of borrowing) as arrived at in the impact assessment at a correspondingly lower nominal tax rate.

The information provided in the impact assessment on the mitigating effects was not the result of a model simulation. Instead – as is clearly stated in the impact assessment (p. 27) - it was provided for illustrative purposes. After all, already before considering the three mitigating effects the impact assessment had arrived at a positive net fiscal balance from taxing the trading in government bonds (additional revenues of about EUR 6.5 bn. were only partially offset by expected additional cost of borrowing of EUR 3.85 bn.). Thus, if one assumed that the three mitigating effects mentioned in the impact assessment were not to have an impact at all, the positive net balance would remain at EUR 2.65 bn. If one assumed that the three mitigating effects fully offset the modelled increase in the cost of capital then the net balance would be EUR 6.5 bn. In the impact assessment it was illustrated what would happen if the mitigating effects had halved the modelled predicted increase in the cost of borrowing (50% of EUR 3.85 bn. or "less than EUR 2 bn."). In such a scenario, the net return of taxing the trading of government bonds based on the initial revenues estimated (2011) would amount to about EUR 4.5 bn. (gross revenue: EUR 6.5 bn., higher borrowing cost: EUR 2 bn., net revenue: EUR 4.5bn.).

Finally, as regards taxing the trading in outstanding government bonds and the cost of borrowing for Member States one needs to well isolate the effects of different variables on the cost of borrowing. The Commission is not aware of any scientific study that has linked the past development of the cost of borrowing for individual Member States to the level or change in transaction costs for trading in secondary markets. While reduced transaction cost might have had a measurable impact on liquidity on these markets, the costs of borrowing were predominantly affected by the tightness of monetary policy, the inflation outlook in a country, the sustainability of public debt as mirrored in a country's debt and deficit performance and a country's current account performance, and the outlook for these variables. The spreads (enjoyed or suffered) by different countries as compared to a benchmark (such as German bunds) were predominantly influenced by these variables, and in how far market actors went (relatively) short or long as regards certain products, be it on secondary markets themselves or be in on derivatives for public debt.

Regarding the low maturity of the repo operations on sovereign bonds market (more than two thirds of repo operations on sovereign bonds have a maturity lower than three days), the tax will induce an additional cost that is not sustainable for the market participants, i.e. companies and Member States which need to manage properly their cash in a secure environment. The extinction of the market will negatively affect the sovereign bonds market and by consequence will raise the government funding costs. Repo operations are very useful for managing the treasury liquidity and the disappearance of this market combined by the lack of viable alternatives will induce serious problems about risk management. The problem also holds for banks in managing their marginal liquidity and might cause both higher financial costs on the real economy and financial stability issues.

Is there an assessment about the effect of the tax on the repo market and therefore on the funding cost of the central government and the real economy?

Furthermore, what impact will the tax have on the costs of government funding taking into consideration the costs of transactions on the repo and cash markets and the efforts to reduce public debt?

Answer:

The RePo market is a significant market in the EU with operations geared especially towards the short term. (Reverse) repurchase and securities lending agreements were included already in the initial Commission proposal of 2011 because of similarities with plain securities transactions in order to ensure tax neutrality (level playing field).

Contrary to what numerous stakeholders claim, there are issues of financial stability around the use of such instruments. Here are some issues raised in the Financial Stability Board (FSB) interim report of April 2012⁴:

"(i) lack of transparency – securities financing markets are complex, rapidly evolving and can be opaque for some market participants and policymakers;

(ii) pro-cyclicality of system leverage and interconnectedness – securities financing markets can influence the leverage, complexity and level of risk-taking within the financial system in a pro-cyclical and potentially destabilising way;

(iii) other potential financial stability issues associated with collateral re-use – collateral re-use can reinforce pro-cyclicality, and may have other potentially destabilising effects on the financial system;

(iv) potential risks arising from fire-sale of collateral assets – non-defaulting counterparties can be expected to sell collateral securities immediately following a default in order to realise cash or buy back lent securities, triggering collateral “fire sales”;

(v) potential risks arising from agent lender practices – agent lenders’ practices in handling customer assets and in offering indemnities to their customers against the risk of borrower default need further investigation;

(vi) securities lending cash collateral reinvestment – by reinvesting cash collateral received from securities lending transactions, securities lenders (including non-banks) can effectively perform “bank-like” activities that involve maturity/liquidity transformation and leverage; and

(vii) insufficient rigour in collateral valuation and management practices – inappropriate collateral valuation and management practices may create vulnerabilities, as seen during the early stage of financial crisis."

In the light of the discussions in the Council already under the Danish Presidency, the Commission has decided for its proposal of February 2013 (as opposed to its initial proposal of 2011) to count RePo transactions as only one transaction (in the initial proposal a RePo counted as two transactions) as such operations are considered to be economically equivalent to one operation (e.g. secured loan).

⁴ FSB (2012) – Securities Lending and Repos: Market Overview and Financial Stability Issues – see: http://www.financialstabilityboard.org/publications/r_120427.pdf

The Commission analysis is based on the assumption that repurchase agreements in those countries and in those cases where they were actually carried out as a purchase/sale agreement as compared to a securities-pledging agreement they would in all likelihood either be partially replaced by securitised lending operations or by purchase/sale transactions with central banks. This should not have an effect on the choice of the underlying collateral. The most preferred collateral in these days are liquid government bonds accepted as collateral also by national central banks or the ECB. The most liquid government bonds in Europe accepted as collateral by all central banks are German government bonds. Therefore, taxing RePo agreements should not dent the attractiveness of government bonds as compared to the attractiveness of other comparable securities and, thus, the liquidity of secondary markets for these bonds.

The Commission has also indicated in the revenue estimations of the impact assessment accompanying the initial proposal (2011), that it was assumed that large parts of (taxable) repurchase agreements would be replaced by (non-taxable) secured loans or other business models, such as non-taxed lending/borrowing operations with Central Banks. This assumption could be considered to be realistic to a certain extent notably for 'over-night' repurchase agreements and for RePo transactions with a very short maturity which make up for the largest part of the market. Please note in this context that RePos with an open maturity would only be taxed once (at the time of conclusion)

While some of the national RePo markets in the EU are (probably due to the different non-harmonised national legal bankruptcy/insolvency regimes or "negative-pledge clauses") characterised by the transfer in ownership of the underlying collateral, RePo markets in the US (with a uniform insolvency regime carving out claims from RePo agreements) and in a limited number of MS are characterised by pledging the underlying collateral. This latter business model would come with no FTT. There is no indication that the money and inter-banking market in the US in these Member States is less efficient and effective than the European one.

Thus, such RePos where the security was used as pledged collateral only could – at least in the medium run – serve as viable substitutes for the business model prevailing and dominating markets in some Member States.

However, if this was not considered to be a viable alternative one could also consider adjusting the tax rate to the tax rate proposed for derivatives. After all, the underlying economic substance of "purchase instead of pledge" is a hedge against a counter-party default risk, similar to a credit default swap, thus, a derivative. Derivatives in the context of an untaxed lending / borrowing operation are to be taxed at a rate of 1 basis point of the amount to be 'insured' by such a derivative.

It is not expected that the taxing of RePo transactions will have a measurable impact on the cost of borrowing for Member States as two attractive untaxed alternatives with a similar economic substance as RePos based on a change in ownership of government bonds as collateral exist (pledging and RePos with Central Banks). Also, a decline in liquidity on RePo markets is not expected to have an impact on the borrowing costs for governments as this decline in liquidity might affect both sides (borrowers and lenders) in the same way. Thus, taxing RePos should have a measurable impact neither on the cost of borrowing of Governments, nor on tax revenues and, thus, on public debt.

- *Tax formula*

Could you state the effects of a tax formula which takes into account the duration of the bond on which the transaction takes place or is it preferable to set up lower minimum tax rates in general? The 0.1% uniform tax rate proposed by the Commission might create an inappropriate burden on short term bonds, repo operations etc, compared to long term bonds. A possible imbalance would have implications on the cost of the debt, including sovereign debt, on financial institutions' refinancing operations, as well as on the part of the asset management industry that is focused on short term maturities

Answer:

It is in the very nature of a tax on transactions that the more frequent such transactions are undertaken the more often the tax will be due. So as to avoid cascading effects within a genuine chain of transactions the Commission has proposed the intermediation-relief of Article 10(2), as well as placing out of scope of the FTT certain entities such as Central Counter Parties, Central Securities Depositories or International Central Security Depositories.

On the other hand, if such a tax is also aimed at generating substantial revenue at low rates (and also to avoid distortions across different kinds of transactions and market segments) it is indispensable that such a tax has to apply to both gross transactions and independent of the frequency a transaction is undertaken. That (amongst others) is why the Commission proposal also foresees the taxation of intra-day transactions, including automated high-frequency trading.

The frequency of transactions is typically determined by the aimed-at expected rate of return and other parameters of the business models of the parties to a transaction. In a world with a tax on financial transactions, one of these parameters could also be the so-called 'annualised effective tax rate', i.e. how much tax would be due if an identical financial transaction is undertaken several times a year, e.g. on a monthly, weekly or even daily basis.

In fixed-income markets, such as markets for government and enterprise bonds and in some derivatives markets, such as the market for options or credit default swaps, the products traded come with an end date, a kind of "best before" date. This "best before" date" might be influenced, i.e. brought forward, by levying a tax on trading such products, and might, thus, negatively impact on liquidity on secondary markets for these products the closer the maturity date comes.

It is now assumed that the authors of the question on the tax formula have in mind a tax formula that calibrates the so-called effective (minimum) annualised tax rate. at 0.1% for (government) bonds and bills, i.e. the trading in bills with a maturity of three or six months would come at a tax rate of 0.025% and 0.05% respectively, while bonds with a maturity of 5 or 10 years would come at a tax rate of 0.5% and 1.0% respectively.

While such an approach might be rather straightforward in case the (purchase at) issuance of such products was taxed, it would be somewhat more complicated under the design of the tax as proposed by the Commission as the (purchase at) issuance is not taxed while the trading on secondary markets is. Thus, the nominal tax rate would have to be adjusted all over the lifetime of each product if one wanted to guarantee the effect the authors of the question seem to have in mind.

A tax formula which takes into account the duration of the (government) bond on which the transaction takes place would put short-term investment at the same footing with long-term investment. It would neither discourage short-term (often myopic) investment behaviour nor reward long-term and strategic investment.

Such a differentiating tax formula would also be much more difficult to manage from a tax administration point of view, especially when having to take into account the remaining maturities of an individual product changing every day in case the formula was not based on a discretionary function but on a continuous function. Also, it would risk to introduce frictions between secondary markets for (government) bonds and bills on the one side and markets and products derived thereof on the other unless such a discretionary / continuous formula was also applied to corresponding derivatives, be they traded on trading platforms or be they agreed upon over the counter.

A uniform rate which does not take into account the duration of (government) bonds and bills implies a higher so-called annualised effective tax rate. than 0.1% for (government) bonds and bills with (remaining) maturities shorter than one year while it would imply a smaller effective tax rate p.a. than 0.1% for (government) bonds with a (remaining) maturity longer than one year.

This could have several effects on yields and market liquidity for the different market segments, some of them offsetting each other:

- Given that primary market transactions are tax free the "run" on primary markets for (government) bonds and bills with a shorter maturity will in all likelihood be more pronounced than the "run" on primary markets for (government) bonds with longer maturities as the opportunity costs of not investing on the primary market would be higher for products with a short maturity as compared to products with a long maturity, notably when the investor applies a (kind of) "buy and hold" strategy. This should drive down borrowing costs for (government) bonds and bills with shorter maturities and, thus, trigger a steepening of the yield curve as a result of reduced short-term borrowing cost.
- On the other hand, the higher effective tax rate p.a. for (government) bonds and bills with a (remaining) short maturity (below twelve months) on secondary markets could exert an upward pressure on yields for these products, thus, partially or wholly offsetting the first effect.
- The attractiveness of (government) bonds with a (remaining) maturity of more than twelve months would rise as the implicit effective tax rate p.a. would fall below 0.1%. This would especially be true in the eyes of those institutional investors that follow a more passive "buy and hold" strategy and that are, thus, more interested in the fixed income earned than in the daily marked-to-market value of the (government) bond itself. This could make investing in long-term bonds more attractive for these actors, thus, triggering a flattening of the yield curve.

- On the other hand, a uniform tax rate independent of the (remaining) maturity of (government) bonds would make the trading in long-term (government) bonds closer to their end date less attractive. This could reduce liquidity on products with a remaining short-term maturity. It would also make less attractive the frequent trading of such bonds as compared to investing in products with a similar maturity on primary markets.

While the net effect might be – if there was an effect at all - an overall flattening of the yield curve of affected product groups it is not clear why such a flattening should constitute an "imbalance".

The effect on that part of the asset management industry that is focussing on investing in products with short-term maturities could be more pronounced than on that part of the asset management industry that is focussing on investing in products with longer maturities. A question in this context might also be to what extent "focussing on investing in products with short-term maturities" actually means. After all, such an asset manager might not have to pay FTT at all in case he bought such products at the time of issue and redeemed it at the time of maturity.

In any case, asset managers focusing on investing in products with short-term maturities and , thus, also having to churn assets more intensively than their competitors might already be characterised by higher management fees and lower yields for two reasons:

- Products with shorter maturity have with typically – i.e. except in the rather rare market constellations characterised by inverse yield curves - a lower yield than products with longer maturities.
- More intensive churning of assets comes at higher transaction cost than less intensive churning.

Thus, in transparent markets such asset managers should attract less investor demand already in a world where such churning was not taxed. The FTT will in all likelihood make this more obvious.

The effects of a uniform tax rate on the financial institutions' refinancing operations should be neutral as it is by now a well-established principle of an adequate risk and maturity management that while allowing for a mismatch in individual cases the overall matching of maturities for assets and liabilities is a pre-requisite for a sustainable business model.

Opting for a lower tax rate for the trading in (government) bonds and bills would have negative implications for revenues and, thus, for consolidating public budgets or for investing in growth-enhancing projects.

- *Non-government bonds*

With regards to other bonds, business have expressed worries that the same effect described above for government bonds would replicate on the corporate issuers, with negative effects on the financing capability of companies. Considering, on the one hand, the difficulties in receiving funding from the banking sector in the present environment, and on the other hand the fact that exceptions on the FTT should be limited/reasonable, MS would like more information on the expected revenues from taxation on non-governments bonds.

Considering all the above, MS would like to receive from the Commission more evidence and information also with regards to the estimated figures related to non-government bonds. Where does COM see the delamination between private and public sector bonds/debt, namely, how are bonds treated that are issued by private companies that are 100% public owned or 100% public guaranteed and how are CoCo bonds treated - as private or as public, regardless of the ownership of the bank?

Answer:

Bonds issued by private companies that are 100% public owned or 100% public guaranteed are to be treated as private. The same holds for contingent convertible bonds. This approach flows both from the overall logic and objectives of the FTT proposal and its wording.

The **revenue estimations** of the impact assessment were based on the following assumptions:

- **Outstanding corporate debt in EU11 in form of enterprise bonds and similar was estimated at about EUR 2.2 trillion.**
- **Given that secondary markets for enterprise bonds are typically less liquid than markets for government bonds it was assumed that only 50% of the outstanding debt was traded annually.**
- **A reduction in market turnover by 15% is assumed at a tax rate of 0.1%, which gives an annual market turnover (after the introduction of the FTT) of EUR 1.1 trillion.**

Under the assumption that both the seller and the buyer were financial institutions, the accruing revenues from the trading in enterprise bonds would be around EUR 1.9 billion for EU11.

With respect to access to finance for enterprises of the non-financial economy the Commission is not aware of any kind of credit crunch exercised by the financial sector. There might, however, be incidences of difficulties in access to finance in those economies that are presently so-called "programme countries" and those that presently suffer from a rather bleak economic outlook, and thus, gloomy profitability prospects of certain sectors notably in these countries. These difficulties in access to finance that are attributable to a downturn in the economic cycle should not be confused with the inability of the financial industry to provide capital.

Also, there does not seem to be a shortage of liquidity in markets or too tight a monetary policy that would hinder banks to provide credit to enterprises. Finally, it should not be forgotten that the traditional way of financing investment, notably by SMEs that represent more than 98% of all enterprises, would not be affected by the (harmonisation of) national taxes on financial transactions as proposed by the European Commission.

- *Primary exemptions on bonds*

Are the acquisitions of UCITS share exempted through the primary market exemption, as defined in Article 3.4.a?

Answer:

The issuance and the sale/purchase of units of UCITS and shares of AIF to/by the first buyer (including the underwriting and subsequent allocation in the framework of their issue) is considered to be a primary market transaction covered by Article 3(4) point (a) of the FTT proposal and thus out-of-scope of the proposed tax (see Explanatory Memorandum to the proposal, p. 9 and recital (9) of the proposal). In the proposal of 2011, while acknowledging that such issue is to be considered a primary market transaction, such issue was proposed to be carved out from the primary-market exemption. This carve out is no longer foreseen in the proposal of 2013.

Are bonds of legal entities guaranteed by Member States included? More generally are all bonds of public entities included (such as local authorities)?

Answer:

Bonds, including those issued by public entities, are covered by the primary market exemption.

Definitions and clarification on the scope of taxation

The 11 MS consider that some definitions should be clarified by the Commission.

- *Purchase and sale*

Article 2, par. 1. (2) (a) mentions “the purchase and sale of a financial instrument before netting or settlement” .

A common definition of “purchase and sale” is essential in order to have: (i) certainty in the legal basis for both taxpayers and tax administrations; (ii) uniformity in the application of the tax among participating MS. Considering that from a legal perspective the different MS may have different interpretation of a “sale” or of a “purchase”, it is considered it as essential to agree on a common definition.

What is the meaning of “purchase” and “sale” based on the Commission’s Proposal? Would it be feasible in the view of the Commission to further define these terms or to come up with alternative terms that are commonly defined within the MS?

Answer:

There is a plethora of financial transactions all having different features and characteristics as regards the products being object of the transaction, the status of the parties involved, the kind of consideration paid or due etc. For the purpose of the harmonisation of the FTT, the Commission has proposed (in Article 2(1) point (2)) to cover the world of financial transactions by establishing five clusters.

Besides the "purchase and sale of a financial instrument (...)" as referred to in Article 2(1) point (2)(a), there are four other clusters of financial transactions referred to in the proposal, i.e. "the transfer between entities of a group of the right to dispose of a financial instrument as owner and any equivalent operation implying the transfer of the risk associated with the financial instrument (...)" (Article 2(1) point (2)(b)), the "conclusion of derivatives contracts (...)" (Article 2(1) point (2)(c)), the "exchange of financial instruments" (Article 2(1) point (2)(d)) and "a repurchase agreement, a reverse repurchase agreement, a securities lending and borrowing agreement" (Article 2(1) point (2)(e)).

Some differences between these clusters are e.g.

- the status of the parties, e.g. the seller and the buyer in the case of "purchases and sales" as compared to the borrower and the lender in the case of "lending and borrowing agreements", or simply a party (not closer defined) in the case of "the conclusion of derivatives agreements",
- the kind of counterparty obligation, e.g. consideration paid in cash or money in the case of "purchases and sales" as compared to the transfer of another financial instrument in the case of "an exchange of financial instruments".

An essential part of the definition of a financial transaction for the sake of the proposed FTT refers to "the purchase and sale" of a financial instrument (Article 2(1) point (2)(b)).

The scope of the terms "purchase and sale" is not limited to the transfer of ownership but rather represents the obligation entered into, mirroring whether or not the party concerned assumes the risk implied by a given financial instrument⁵. This meaning of the terms "purchase and sale" is partly derived from their concept in the MiFID legislation⁶.

⁵ See also: Explanatory memorandum to the proposal: p. 8.

⁶ EP and Council Directive 2004/39/EC and its level 2 legislation (Commission Regulation (EC) 1287/2006).

Refining or expressly defining the terms "purchase and sale" in a text to be adopted by the participating Member States is of course an option not to be excluded but the Commission analysis so far has identified the stark divergence of the relevant national civil laws as an obstacle difficult to overcome and thus relied on terms that are enshrined in existing EU legislation and practically applied by administrations and operators, and without any kind of problems. Any constructive proposal for a more refined definition of "purchase and sale" could be discussed and agreed upon in case it was clarifying the issue. However, such clarification should neither undermine the aimed at objective of covering all transactions in financial instruments nor open the potential for an untaxed loophole. Of course, all participating Member States would have to agree on this.

- *Netting and settlement*

The reference to the Article 2, lett. k, of the Directive 98/26/EC of the European Parliament and of the Council for the meaning of netting does not seem sufficient to clarify it. Indeed, the Directive affirms: "netting shall mean the conversion into one net claim or one net obligation of claims and obligations resulting from transfer orders which a participant or participants either issue to, or receive from, one or more other participants with the result that only a net claim can be demanded or a net obligation be owed". The reference to this Article does not clarify if the Commission wants to refer to the netting by single instrument, per day, per financial institution etc.

The 11 MS ask for clarifications on this. As mentioned above, they consider that also the meaning of settlement should be more detailed.

Answer:

The purpose of the addition "before netting and settlement" is to clearly indicate that the proposed FTT aims at taxing gross transactions (Explanatory Memorandum, p.8, first paragraph), including intra-day trading and high-frequency trading, i.e. before netting and settlement and not after netting and settlement.

Every single transaction (before netting and settlement) which effectively occurs is taxable. The FTT is chargeable for each financial transaction at the moment it occurs (Article 5 of the FTT proposal). Netting and settlement, cancellation or rectification of transactions has as a rule no effect on the chargeability of the proposed FTT. A material modification of an operation as referred to in points (a) to (e) of paragraph 1(2) of Article 2 would even constitute a new transaction (Article 2(2)).

The term "settlement" does not seem to be defined specifically in EU financial services legislation. However, there are similar definitions in the CPSS (BIS), ECB and DG MARKT glossaries:

- BIS: "The completion of a transaction, wherein the seller transfers securities or financial instruments to the buyer and the buyer transfers money to the seller. A settlement may be final or provisional."
- ECB: "The completion of a transaction or of processing with the aim of discharging participants' obligations through the transfer of funds and/or securities. A settlement may be final or provisional."

- **DG MARKT glossary: "The completion of a transaction or of processing with the aim of discharging participants' obligations through the transfer of money and/or securities."**

"Netting" in the FTT proposal refers to any kind of netting.

In any case, only the underlying original transaction is intended to be taxed under the directive proposed by the Commission. Post-trading operations, such as netting and settlement or post-trading portfolio compressions are activities that constitute part of the ex-post management of the initial transaction taxed and should, thus, be out of scope of the directive.

- *Cancellation and rectification*

Article 5 of the Proposal states that *"subsequent cancellation or rectification of a financial transaction shall have no effect on chargeability, except for cases of errors"*.

The 11 MS would like to have clarification on the meaning of *"cancellation or rectification"*.

Answer:

Under the FTT proposal, cancellation of a financial transaction would mean the annulling of that transaction in full or in part. A rectification of a financial transaction would refer to its modification, in particular as regards the parties to the transaction, the object or scope, the consideration agreed upon, the timing etc.

The provision of Article 5(2) stipulates that the subsequent cancellation or rectification of a financial transaction shall have no effect on chargeability of the initial transaction, except for cases of errors. It means thus that such cancellation or rectification does have no effect neither on the taxability of the initial transaction nor on the tax base and tax rate applied, except for cases of errors.

- *Pension funds (Art.2, par.1, nr 8, lett.f)*

The 11 MS would like to have clarification on the definition of pension funds. In particular, are both Pillar II and Pillar III included? In addition, reference is also made to *"investment managers of such funds"*: are all pension funds management companies included?

Answer:

The word "pension fund" in Article 2(1) point (8) (f) is general in nature and refers to any funded pension scheme (thus, for which assets are managed). The same holds for the pension fund investment managers.

The purpose of including pension funds and their investment managers is to put them at equal footing with other asset managers.

While it is acknowledged that pension funds and their investment managers are deemed to be fulfilling a function that is supported by both national and European policies it should also be kept in mind that they and the savers investing in such funds already benefit – exactly for this reason – from privileged treatment at the national level, e.g. by making investment in such funds income-tax deductible (which is not the case for private households investing in shares or government or enterprise bonds) or by propping up with public money investment in such funds and their products (e.g. Riester Rente in Germany).

Thus, it is assumed that the public (financial) support given to such products at national level already mirrors in full national preferences and that additional privileged treatment of such funds would risk to trigger distortions across markets and actors instead of correcting market failures.

- definition of „undertaking...“ (Art. 2, par.1, nr 8, lett. j, point ii)

Clarity is needed in the definition of this activity.

Answer:

The purpose of Article 2(1) point (8) (j) of the proposal is to ensure a broad definition of financial institutions by including (any other) institution/undertaking/body/person which carries out financial activities relevant for the application of the proposal and which have a significant amount of financial transactions, to an extent that their core business seems to be rather financial than other. This broad definition of financial institution aims at avoiding economic distortions and tackling tax avoidance.

The financial activities mentioned in Article 2(1) point (8) (j) are essentially based on the list of activities contained in Annex I to the Directive 2006/48/EC relating to the taking up and pursuit of business of credit institutions.

As regards in particular the point (8)(j) (ii) of Article 2(1), it is general in nature and thus has a wide coverage; it is intended to cover what the proposed tax as a rule captures, i.e. transactions carried out by what is usually understood as financial institutions acting either for own account or for the account of another person or in the name of another person (provided the other conditions of Article 3(1) are fulfilled). This definition also captures legally independent treasury departments of groups of undertakings or multinational enterprises that are specialised in carrying out transactions in financial instruments as defined in the proposal.

- definition of „undertaking ...“ (Art. 2, par.1, nr 8, lett. j, point iv) and v)

This part of the definition seems to be according to our reading not consistent with Art. 3, par.4, lett. a) where these primary market transactions are excluded from the scope

Answer:

The points (iv)-(v) of Article 2(1) point (8)(j) refer to the definition of any other undertaking, institution, body or person as a financial institution that carries out activities of participation in or issuance of financial instruments (as defined in the proposal) or the provision of services related to therein which indeed might fall under the out-of-scope provision for primary market transactions. However, such activities of such undertaking, body or person might include also other activities, such as e.g. the issuance and sale of derivatives not covered by the primary-market exemption envisaged in the proposal, which do generate in-scope transactions.

High Frequency Trading

The 11 MS would like to ask the Commission which would be the impact of their Proposal on High Frequency traders.

What would be the impact of the Proposal on High Frequency traders in the context of taxing intraday transactions? Are modifications and cancellations taxed? Are orders sent, even if cancelled or modified, taxed?

Answer:

Already in Annex 14 of the initial IA (on effects on market stability and risks) the Commission has indicated that "the FTT would serve as a tool to deal with the challenge of short-sighted profit-seeking behaviour" and that "it could also help to reduce the rents of the financial sector generated by activities such as high-frequency automated trading".

The proposed FTT aims at taxing every single transaction on a gross basis. Consequently, intraday transactions would be taxed, assuming all conditions for taxation are fulfilled.

Cancellation and modifications of transactions have no impact on the taxation, except for cases of errors (Article 5(2)). However, any material modification of transactions is considered to be a new operation of the same type as the original one (Article 2(2)).

Orders not resulting in a financial transaction as defined in the proposal (Article 2(1) point (2)(a)) are not taxed; neither are such orders that are cancelled or modified.

As a result of the tax high frequency traders would have to adjust their algorithms as it would no longer be economically meaningful to go for each and every transaction how tiny the profit is. Instead, they would need to "wait" for deals that earn a small profit and on top of this the FTT due.

Joint and several liability

The 11 MS would like some more clarifications and examples on par.3 of Article 10 of the Proposal, stating that "*where the tax due has not been paid within the time limit set out in Article 11(5), each party to a transaction, including persons other than financial institutions shall be jointly and severally liable for the payment of the tax due by a financial institution on account of that transaction*".

In practice, how will the provision of joint liability work? How will the “customer” or other entity in the chain know if the financial institution has paid or not a tax for which the financial institution is liable? Can the Commission make some examples on how it could work? (Is it possible that very often parties do not know which are all the financial institutions involved in the chain of the transaction since most of financial transactions are anonymized and the parties do not know each other’s on organized markets before the execution of the transaction)?

Answer:

Examples of joint and several liability under Article 10(3) of the FTT proposal can be found in Room Document # 3 to the Council WPTQ meeting of 16 April 2013.

When collecting the tax, the participating Member States should be able in the first instance to apply effective and straightforward collection methods (see: the reply to the above question on the tax collection) which either rely on the liable financial institution or on centralised collection methods. The collection methods are still under examination.

Joint and several liability under Article 10(3) is merely foreseen as a safety net in cases where the payment by the prime liable person cannot be assured. The possible use of joint and several liability might however be an extra incentive to transact with credible and tax compliant counterparties or for trading venues to allow only such parties. It is also expected that business practices will adjust to this feature rapidly.

Furthermore, collection of the tax by means of the joint and several liability provision outside the FTT jurisdiction faces the same legal issues as the basic collection of the tax outside these jurisdictions.

The "anonymity" issue referred to in the question could typically occur when trading platforms, central counter parties or other central clearing infrastructures were involved. The easiest way to overcome this issue – and a potential counterparty non-compliance risk - would be to let the tax be collected and paid directly by the market infrastructure operator such as the trading platform (when executing the sale/purchase) or the Central Counter Party (when novating the contract). In case these market infrastructure operators entered into enforceable contractual relationships with the participating Member States in which they agree to collect the tax on behalf of the tax authorities, such market infrastructure operators might be "certified" in return to that end so that trading, clearing etc. on or with the help of "certified platforms" would no longer come with a liability risk on the side of the parties to the transaction. This would constitute be a "business case" for voluntary tax compliance.

Further clarification on the Commission's impact assessment

According to the Commission, the impact on traded volumes (-15% for securities) is an "ex-ante" working hypothesis.

Considering the importance of this hypothesis on impact assessment both in terms of market reactions and tax revenues, can the Commission elaborate on how it estimated such impact, especially between the different securities depending on the issuer (sovereign, corporate, etc.), maturity (short or long), and current liquidity?

Answer:

The assumptions on market reaction were made in the context of producing conservative revenue estimates. They were not the result of a detailed evaluation of all potential market reactions for all market segments. As explained in the Annex 11 on revenue estimates of the initial impact assessment, estimating revenue for taxes which would be newly introduced and which have the goal, even if subordinated, or are expected to change market behaviour and structure significantly is not feasible without a high degree of uncertainty due, for example, to the unknown effects of the tax on high-frequency trading and other market segments.

Based on reactions identified in different studies, the 15% was chosen as an up-front decrease in trade volume accounting for example for the probable disappearance of some high frequency trading and a high price elasticity of both demand and supply to an increase in transaction costs and, thus, the total price. This estimation did in first place not follow an approach differentiating by maturity of products, especially as it had been initially triggered by analysing the effects of a tax on the trading in enterprise shares that come with no maturity.

As regards fixed-income products such as government bonds it had first been assumed that their trading (please note the different argumentation for RePos) takes place less than once a year, in line with empirical evidence on the investment behaviour of typical institutional investors specialised on investing in fixed-income assets (see also the reply to the questions on revenue estimations for government bonds). Then, account had to be taken of the fact that primary market transactions, i.e. the issue of bonds and bills including the activity of underwriting and their subsequent allocation in the framework of their issue as well as their redemption at the moment when they mature do not come with a tax.

Thus, the shorter the maturity of a fixed-income product is the more likely will it be that it will not be traded at all and that no tax will be due at all either. Finally, it was assumed that the effects of a higher so-called 'effective tax rate p.a.' for products with a maturity of less than twelve months and actually been traded and the effects of lower 'effective tax rates p.a.' for products with a maturity of more than twelve months offset each other (see also the reply to the question on the tax formula for bonds and bills) so that an 'effective tax rate p.a.' of 0.1% could be assumed for the entire market segment of fixed-income products.

Finally, it was analysed what could be the reactions of markets to a tax rate of 10 basis points on demand. Assuming (i) a price elasticity of demand of 1.5, i.e. a reduction in the annual yield by 1% triggers a decline in demand by 1.5%, and (ii) assuming an average yield on outstanding (government) bonds and bills for the eleven participating Member States in the order of magnitude of 100 basis points a tax rate of 10 basis points (which corresponds to 10% of the assumed yield) would trigger a decline in demand by 15%.

The assumption of a reduction in turnover on markets for fixed-income products by 15% can be taken as being very conservative and cautious (i.e. being an upper-end assumption), given that the typical average yield of outstanding public debt in participating Member States is much higher even in these times of excessive liquidity and a very loose monetary policy with nominal interest rates by central banks close to zero.
