‘DON’T TAX YOU, DON’T TAX ME, TAX THE CORPORATIONS ACROSS THE SEA’[1]: EXAMINING THE EUROPEAN FINANCIAL TRANSACTION TAX AS A MODEL FOR TAX MULTILATERALISM

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Abstract: In light of the COVID-19 crisis, enthusiasm for a European Financial Transaction Tax (FTT) has been revitalised, driven by similar economic factors as the decade before. As such, this essay offers a timely exposition of the failures of the original FTT proposals by bringing together academic literature on the European FTT with that of FTTs in general within the larger framework of international tax cooperation. By dissecting the reasons for the failure of the European FTT, this essay will make two key arguments. The first is that the significant design flaws of the FTT played the most significant role in its failure. The second key argument is that the experience of the FTT highlights exactly why tax multilateralism is increasingly important in the international tax order and that despite the eventual failure of the proposals, the EU remains the most accessible international forum in which to foster multilateral tax cooperation.

A. INTRODUCTION

Between 2011 and 2013, the European Commission (EC) proposed two directives for a European-wide Financial Transaction Tax (FTT). An FTT is an indirect tax levied on a small percentage of a financial transaction’s value. In the aftermath of the 2008 financial crisis, the enthusiasm for an FTT exploded as European countries tried to find new tax bases from which they could revenue could be raised. Many legislators felt that the financial sector ‘owed’ them since the crisis had been a product of ‘massive financial market failures’ and that this, in turn, demanded a vast amount of government spending on bailing out the system.[2] The EC makes explicit reference to the need for a new tax due to the costs of the various bailouts, estimated at €4.6 trillion across Europe.[3] The damage done to the global economy was not proportional

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[1] Michael Graetz, ‘Bringing International Tax Policy Into the 21st Century’ (2016) 83 Tax Notes International 315, 317.

[2] Leonard E Burman and others, ‘Financial Transaction Taxes in Theory and Practice’ (2016) 69(1) National Tax Journal 171, 171. See further Lisa Kastner, ‘How the financial industry mobilized against the European Financial Transaction Tax’ (*University of Sheffield Political Economy Research Institute,* 21 May 2017) <http://speri.dept.shef.ac.uk/2017/05/21/how-the-financial-industry-mobilized-against-the-european-financial-transaction-tax/> accessed 9 June 2022.

[3] European Commission, Impact Assessment Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC SEC (2011) 1102 final.

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to the amount of tax paid by the financial system and the burden fell on the public to cover the deficit in public expenditure. Against this backdrop, the idea of an FTT surged in popularity in 2009 in the Group of 20 meetings and national parliaments.[4] Nevertheless, both FTT proposals failed to pass as Member States were unable to reach a final agreement on the design of the tax. As the decade progressed, enthusiasm for the tax waned and multiple deadlines for the FTT passed without any resolution.[5]

In light of the COVID-19 crisis, enthusiasm for a European FTT has once again been revitalised, driven by similar economic factors as the decade before.[6] In the European Union (EU), the economic recovery from COVID-19 is estimated to cost upwards of €750 billion, which, when combined with unresolved systemic issues from the 2008 financial crisis (like the under-taxation of the financial services sector and public sector debt), make the FTT more appealing than ever.[7] In February 2021, the current Portuguese Presidency of the EU Council invited the Working Party on Tax Questions to exchange views on the way forward with the FTT.[8] Subsequently, a meeting of the European Parliament in March 2021 adopted a three-step roadmap for regulations, which involves a renewed Commission proposal for the FTT to be put on the table by June 2024.[9]

As such, by exploring the pre-existing academic literature on the European FTT and FTTs in general, this essay offers a timely exposition on the failures of the original proposals and situates the European FTT within the larger framework of international tax cooperation. By dissecting the reasons for the failure of the European FTT, this essay will make two key arguments. The first is that the significant design flaws of the European FTT, compounded by the political architecture of the European Union, played the most significant role in its failure. Nevertheless, this essay goes on to argue that the EU remains the most accessible international forum in which to foster multilateral tax cooperation, which is becoming increasingly important in the international tax order.

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[4] International Monetary Fund, 'A Fair and Substantial Contribution by the Financial Sector: Final Report to the G20' (2010); European Commission 'Taxation of the Financial Sector' COM (2010) 549 Final.

[5] Jim Brunsden, 'EU financial transaction tax progress stalls', *Financial Times* (5 June 2016) <https://www.ft.com/content/ab4ad04c-29ae-11e6-8ba3-cdd781d02d89> accessed 9 June 2022.

[6] James Henry, David Hillman, and Nicholas Shaxson, 'The Time for Financial Transaction Taxes is Now', (2021) 101 Tax Notes International.

[7] Lionel Laurent, 'The EU's Tobin Tax Is Being Resurrected' *Bloomberg* (27 July 2020). <https://www.bloomberg.com/opinion/articles/2020-07-27/the-eu-s-financial-transaction-tax-is-resurrected> Accessed 1 May 2021.

[8] Council of the European Union, Working Party on Tax Questions (Indirect Taxation – FTT) Notice of Meeting and Provisional Agenda, CM1725/21.

[9] European Parliament, 'MEPs clear another hurdle for the COVID-19 recovery plan' (Brussels, 25th March 2021) <https://www.europarl.europa.eu/news/en/press-room/20210322IPR00517/meps-clear-another-hurdle-for-the-covid-19-recovery-plan> Accessed 9 June 2022.

The first section surveys the intellectual history and background of the FTT, providing a context for the FTT in the international tax law framework as well as the legislative history of the EC's two FTT proposals. The second section provides a textual analysis of the respective proposals and their impact, highlighting the design failures of the FTT. The last section explores the FTT proposals considering the objectives outlined by the Commission and examines the FTT as a model for tax multilateralism, arguing that despite the proposals' failures, Member States should cooperate within the EU to reap the benefits of multilateral tax cooperation.

B. THE FINANCIAL TRANSACTION TAX AS A SOLUTION

1. International Tax Framework

Firstly, the FTT should be situated in the broader context of the international tax framework The orthodox conception of taxation argues that taxes are levied by sovereign states that 'wield exclusive power to make and enforce mandatory rules'.[10] The sovereign is entrusted with exclusive powers over taxation to maximise welfare and (justly) redistribute tax revenue. As a result, one of the core tenets of sovereignty is the ability to make and set tax policy.[11] However, this is no longer entirely true.

The globalisation, and more importantly digitalisation, of the global economy, has challenged this orthodox conception and overturned notions of sovereign control. In the twenty-first century, states must compete to solicit residents, companies and investments. Consequently, individuals and multinational enterprises (MNEs) can 'buy *a la carte* fractions of taxing regimes', thereby 'marketising' and 'fragmentising' the traditional state-subject relationship.[12] Regardless of states' attempts to protect their sovereign taxing rights, globalisation has ushered in an era of tax competition, which has seen countries steadily reduce their tax rates to compete for investment. Tax competition is marked by a system of fiscal interdependence such that 'the fiscal policy of one jurisdiction creates externalities for other jurisdictions in the sense that it affects their tax bases'.[13] As one country adjusts its rates down, others typically follow to remain competitive.

Our current system of international tax is deeply entrenched with the notion of state sovereignty such that tax cooperation is viewed as a constraint on sovereignty instead of an

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[10] Tsilly Dagan, *International Tax Policy: Between Competition and Cooperation* (CUP 2017) 12.

[11] Organisation for Economic Cooperation and Development, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing 2013) 9.

[12] Dagan (n 10) 26.

[13] Peter Dietsch, *Catching Capital: The Ethics of Tax Competition* (OUP 2015) 36.

opportunity. Nonetheless, coordinating tax policy on a multilateral level could reap benefits for the countries involved and offer relief from unilateral attempts at protecting the tax base in any one state. Thus, multilateral tax cooperation is best summarised as an opportunity to 'create *global* channels of redistribution' where 'tax competition as one of the forces of globalisation makes *national* redistribution more difficult'.[14]

International cooperation versus competition has been sorely debated amongst tax academics but putting this debate in the context of the EU offers some interesting opportunities.[15] Typically, sovereignty and tax cooperation have been seen as trade-offs. This is also true in the ambit of EU law where the price of harmonisation is national sovereignty. Landmark cases of the European Court of Justice (CJEU) like *Van Gend en Loos* 'crystallise the partial surrender of national sovereignty' to this supranational body.[16] However, Member States have knowingly agreed to limit their sovereignty by virtue of the foundational EU treaties in exchange for the benefits associated with coordinated action across Member States. To that end, the EU has already made large strides towards tax harmonisation, particularly in indirect taxes. Ultimately, the idea behind a coordinated approach is, therefore 'to match economic globalisation with certain forms of political governance with a global reach'.[17] The EU context can do just that: it would utilise the overarching supranational political structure, and 'de facto European constitutional order' provided by the EU to foster discussions about tax rates, structure and redistribution while protecting the sovereignty of Member States through the machinery provided for in the EU Treaties.[18]

2. *Historical Background of FTTs*

The idea for an FTT-type tax was originally proposed by John Maynard Keynes in the aftermath of the Great Depression in 1929.[19] Keynes observed that the fluctuations on the New York Stock Exchange had been far greater than those in London where sales of shares were taxed in the form of the Stamp Duty. Keynes believed a small tax on stock market

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[14] ibid 65.

[15] See more Dagan (n 10); Dietsch (n 13).

[16] Ricardo García Antón, 'The Limits on Tax Sovereignty Imposed by the Interpretation of Supranational Law' in Pasquale Pistone (ed) *European Tax Integration: Law, Policy and Politics* (IBFD 2018); Case C26/62 *Van Gend en Loos v Netherlands Inland Revenue Administration* [1963] ECLI:EU:C:1963:1.

[17] Dietsch (n 13) 65.

[18] Andreas Follesdal. 'The legitimacy deficits of the European Union' (2006) Journal of Political Philosophy 14(4) 445.

[19] Yago Álvarez Barba, 'The Impact of a Financial Transaction Tax on economic recovery and Financial Stability' (Rosa Luxemburg Stiftung, 16th December 2020), 9, <https://www.rosalux.eu/en/article/1850.the-impact-of-a-financial-transaction-tax-ftt-on-economic-recovery-and-financial.html> Accessed 1st May 2021.

transactions could reduce volatility and argued that the lack of a tax made it easier for inexperienced speculative traders to enter and subsequently crash the market.[20]

In 1972, the economist James Tobin revived Keynes' proposal in the form of a Currency Transaction Tax (CTT), in the aftermath of the fall of the Bretton Woods system. Under this system, 44 countries agreed to adopt monetary policies that maintained their respective exchange rates within 1% of the value of gold in return for the US Treasury's promise of the convertibility of gold to US Dollars. However, President Nixon's unilateral termination of the convertibility of gold brought the system to an abrupt end in 1971, but in doing so led to the US dollar becoming the sole backing of several currencies and a *de facto* global reserve currency. The US' unilateral revocation of their commitment to exchange US dollars with gold, wreaked havoc on the markets as fear and uncertainty caused remarkable inflation of the actual value of assets in multiple currencies.[21] Countries that had previously been party to the Bretton Woods agreement were forced into floating currency exchange markets and to undertake interventionist monetary policy unlike ever before, as enormous speculation depreciated the value of the US dollar. Other similar currency shocks were seen in Europe where the fallout of Nixon shock manifested itself in the form of the 'snake in the tunnel' currency system.[22] Under the system, the countries of the European Economic Community agreed to effectively peg their currencies against each other. The 'snake' quickly collapsed in 1973, when the US Dollar began floating freely and large commodities shocks made it unsustainable. While stability in the European markets was subsequently attempted through the inception of the European Monetary System,[23] Tobin was much more sceptical of the currency market's ability to regulate itself. He formulated a simple indirect tax on 0.5 – 1% of the volume of the transaction.[24] The idea was that the tax would reduce volatility on the currency markets and dissuade speculators who typically invested in foreign exchange instruments.[25]

CTTs have since been expanded by policymakers to capture a wider scope of financial transactions, necessitated by innovation in the financial sector. For example, Tobin did not include foreign exchange derivatives at the time of his proposal due to their limited popularity.

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[20] John Maynard Keynes *The General Theory of Employment, Interest and Money* (Palgrave Macmillan 2018), ch12, pt VI, 139-141.
[21] Anne-Marie Gulde, Atish R. Ghosh, and Holger C. Wolf, *Exchange rate regimes: choices and consequences* (MIT Press 2002) 19.
[22] 'Report to the Council and Commission on the realisation by stages of the Economic and Monetary Union in the Community' (Werner Report) (1970) Supplement to Bulletin – 1970 of the European Communities.
[23] See more Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System*, (Princeton University Press 2019).
[24] James Tobin, 'A Proposal for International Monetary Reform' (1978) 4(3) *Eastern Economic Journal* 153, 155.
[25] Álvarez Barba (n 19) 9.

However, the financial market for derivatives has subsequently exploded, as has the endless range of hybrid financial instruments. This expansion is indeed understandable: as countries are on the quest for new tax bases, the expansion to cover all financial transactions is an easy way to raise more revenue.

3. *The FTT in the European Union*

a) *EU Fiscal Harmonisation and Taxation*

Tax policy in the EU is divided into two separate areas: direct taxation and indirect taxation. In the past, the EU has refrained from making laws in the area of direct taxation because the Union lacks the explicit legislative competence to do so. As such, the competence to tax directly is primarily retained and exercised by the Member States. The EU has, however, aided in the approximation of standards for corporate tax, personal tax and tackled tax avoidance and double taxation. These actions are only permitted, if unilateral direct taxation would impede the establishment or functioning of the internal market as per Article 115 of the Treaty on the Functioning of the European Union (TFEU).[26] Direct tax law in the EU has also been heavily shaped by case law on the fundamental freedoms of movement (of goods, capital, services, and people). [27]

EU law provides a more explicit basis (Article 113 TFEU) for the harmonisation of indirect taxes but also only to the extent that it would otherwise impede the functioning of the internal market and distort competition in the EU.[28] In this field, the EU has taken much bigger strides with, for example, harmonisation on value-added tax (VAT) and excise duties. Even then, the TFEU safeguards Member States’ taxing rights extensively by adopting a special legislative procedure and requiring unanimity to adopt harmonisation provisions because the right to tax is so closely connected with the idea of sovereignty. Nevertheless, the moves towards tax harmonisation in an era of immense tax competition underscores how the EU naturally lends itself as a forum for experimentation with tax multilateralism. It already effectively provides a piece of semi-constitutional machinery that attempts to balance Member States’ sovereignty with the interests of the internal market through the principles of subsidiarity and proportionality in Article 5 of the Treaty on the European Union (TEU).[29]

b) *Procedural History of the European Commission Proposals*

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[26] Consolidated Version of the Treaty on the Functioning of the European Union (TFEU) [2012] OJ C326/47.

[27] See more, Christiana Panayi ‘The Harmonisation of Direct Tax Law’ in Alicia Hinarejos and Robert Schütze (eds) *EU Fiscal Federalism: Past, Present, Future* (OUP, forthcoming).

[28] TFEU [2012] OJ C326/47.

[29] Consolidated Version of the Treaty on European Union (TEU) [2012] OJ C326/13.

In September 2011, the Commission proposed an EU-wide FTT ('2011 Proposal') using Article 113 as its legislative basis.[30] By the middle of 2012, EU Finance Ministers decided that they would not reach a unanimous decision on the 2011 Proposal because they could not agree on a design for the tax. Nevertheless, in September 2012, the EC received a request from a group of 11 Member States who expressed a willingness to go forward with an FTT based on the Commission's initial proposal.[31] These States requested that the proposal be pushed through by way of the enhanced cooperation procedure (ECP), a strict legislative procedure that allows a stalemate to be overcome through the continued cooperation on the proposals of only willing Member States. A revised FTT proposal followed in 2013 ('2013 Proposal') following from the 2011 Proposal in form and substance. While the proposal was approved by the European Parliament in July 2013, the participating Member States were unable to reach an agreement on the exact design of the tax.

c) Objectives of the European FTT

The proposal's objectives were four-fold. Firstly, to ensure that financial institutions make a fair and substantial contribution towards the cost of the financial crisis and raise revenue to compensate for under-taxation because of the VAT exemption enjoyed by the financial sector.[32] The second was to create 'disincentives for transactions that do not enhance the efficiency of financial markets'. [33] Moreover, the proposal had a harmonising objective 'to avoid fragmentation of the internal market' that might be caused by uncoordinated national tax measures.[34] Lastly, the FTT aimed to demonstrate 'how an effective FTT can be designed … [to] pave the way towards a coordinated approach with the most relevant international partners'.[35]

This is where the cracks in the FTT start to appear clearly. It is not easy to design a tax with 'limited and acceptable negative side effects' that is simultaneously robust enough to tackle the issues of tax avoidance, prevent the relocation of entities and activities, tackle negative externalities in the financial markets and compensate Member States.[36] The endless list of objectives stated in the Commission's proposals is enough to make one question how all of this

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[30] European Commission, Proposal for a Council Directive on a common system of financial transaction COM (2011) 594 final, s3.1.
[31] Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia, and Slovakia.
[32] COM (2011) 594, s.1.1.
[33] ibid.
[34] ibid.
[35] ibid s.1.4.
[36] Anzhela Cédelle and John Vella, 'Differentiated Integration in the EU: lessons from the Financial Transaction Tax' in Panos Koutrakos and Jukka Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Edward Elgar Publishing 2017) 358.

can be achieved in one directive. Essentially, the FTT asked one simple tax to do too much heavy lifting, and the Member States' failure to come up with an agreeable proposal stands testament to this. In Section D, this essay will highlight how the design of the FTT made it unfit for the achievement of these objectives.

4. The Importance of Tax Multilateralism

The efficacy of an FTT is underscored by the need for multilateral cooperation to reinforce it. For a tax on financial transactions to be the most effective, it should be applied worldwide according to the same rates and bases.[37] Tobin had long considered the multilateral application of the tax as a *conditio sine qua non* for it to work most efficiently. This can be seen through the traditional economic model of the 'prisoner's dilemma' where countries could reap higher rewards with fewer negative effects on the financial sector if they cooperated.[38] At the same time, each country has the incentive to break the arrangement and drop its tax rates to reap the economic rewards associated with being a tax haven. Without convergence on international tax policy, the implementation of an FTT could easily lead to the relocation of financial activity to a non-participating jurisdiction.

This, therefore, highlights two important design problems for any FTT. The first is the problem of activity relocation as unilateral or geographically limited implementation could lead to the erosion of the tax base in any one country by shifting financial activity offshore. Such a problem was observed when Sweden introduced a national FTT on the purchase and sale of Swedish shares in the country. As a result, investors simply moved to an international marketplace but traded the same shares and by 1990, over 50% of Swedish shares were traded in London.[39]

The second issue is that of instrument substitution where a tax base may be eroded by a shift in trading behaviour to non-taxable instruments. This was also observed in Sweden where some types of derivatives were not subject to the tax and surged in popularity as a result.[40] This is a well-observed pattern with FTTs, not just in the Swedish example but also with the French FTT introduced in 2012. While the Swedish FTT faced major base erosion issues due to design flaws making it easy to avoid, the French example is significantly more worrying because it demonstrates that even a well-designed FTT can negatively affect market behaviour. The French FTT levies a 0.2% tax on stock purchases of French publicly traded

[37] Burman and others (n 2) 185.
[38] ibid.
[39] Magnus Wilberg, 'We tried a Tobin tax, and it didn't work' *Financial Times* (Stockholm, 15 April 2013) <https://www.ft.com/content/b9b40fee-9236-11e2-851f-00144feabdc0> accessed 1 May 2021.
[40] ibid.

companies with a market value of over €1 billion and a 0.015% tax on high-frequency trading orders. The French government, aware of the possibility of driving transactions offshore, allowed exemptions for corporate bonds, sovereign bonds, and derivatives but this did not stop the FTT from 'reduc[ing] trading volume significantly'.[41] In the French case, not only did trade move to other European countries but also to smaller firms that were exempt from the tax.

Ultimately, these issues go hand in hand. For one, the finance industry is extremely innovative and attempts to impose a tax on financial activity can easily be pivoted around by the creation of derivatives or hybrid financial instruments that essentially have the same economic function as the original instrument but formally avoid the tax. Moreover, these instruments can be traded offshore to achieve the same economic value while avoiding the tax. Thus, to prevent activity flight from an FTT, there needs to be multilateral cooperation to converge policy in a favourable way that does not erode the tax base in any one country but multilaterally applies to the same rates and bases, making it difficult to avoid.

Notably, at first glance, the tax rates proposed by various FTT seems rather insignificant, typically set between 0.1-0.2% of the transaction's value. However, the cost of the tax would add up over multiple high-volume transactions, especially given the frequency of securities trading, making avoidance even more attractive. To some extent the reduction in trading volumes is a positive thing: the FTT aims to curb speculative trading, so a decline is not only expected but a sign that it is working. It is, however, important then to distinguish the point at which reduced trade is unproductive (like in Sweden) and whether the costs of simultaneously discouraging productive financial activity are worth this reduction. Significantly, this means that almost any version of the European FTT introduced under the ECP procedure would have had a host of negative effects because differentiated integration would create a clear distinction between participating and non-participating Member States and open the tax up to the issues highlighted here (see further in Section C). This next section will provide an analysis of the respective proposals and their potential impact.

C. LEGAL AND FISCAL LIMITATIONS OF THE PROPOSALS

1. *Design of the 2011 Proposals*

The FTT is a form of indirect taxation, as it taxed 'an indirect index of wealth, such as consumption of financial services'.[42] Moreover, some like De la Feria have argued that the

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[41] Burman and others (n 2) 178.

[42] Pablo Hernández González-Barreda, 'On the European Way to a Financial Transaction Tax under Enhanced Cooperation: Multi-speed Europe or Shortcut?' (2013) 41(4) Intertax 208, 220.

rationale and regulatory dimensions of the FTT make it a hybrid between a proxy tax (a tax levied to compensate for an exemption) and a regulatory tax (a Pigouvian tax) instead of a pure indirect tax.[43] While these aspects of the tax are certainly pertinent, both the FTT's regulatory function and ability to compensate for under-taxation are called into question later in this essay. As such, the FTT is best treated as an indirect tax given its proposed object and function.

The FTT would tax financial transactions as they were exchanged at a minimum base rate of no less than 0.1% of the transaction's value and at 0.001% of the nominal value for derivatives. The original design of the tax was intentionally broad, to compensate for the weaknesses of FTTs and intended to close loopholes for avoidance through straight substitution like in the Swedish FTT (highlighted below). Particularly, when the tax was shifted from a CTT to an FTT, the risk of tax avoidance would be higher if the Commission followed an itemised approach to financial instruments. Instead, the Commission adopted a 'triple-A approach' by applying the FTT to *all* markets, *all* instruments and *all* financial institutions.[44] The tax would have applied to the purchase and sale of a wide range of financial instruments including repurchase agreements (repos), reverse repos, securities lending and borrowing agreements' to name a few.[45]

The 2011 Proposal also adopted the 'residence principle'. This principle determined the territorial scope of the tax and the allocation of taxing rights amongst the states. Thus, financial transactions were only subject to the FTT if at least one party was established in a Member State and if a financial institution established in a Member State was party to the transaction, either in its own capacity or in the capacity of a client.[46] The 2011 Proposal's definition of 'establishment' in Article 3 was intentionally (and controversially) broad. Establishment ranges from having a registered seat (i.e., an incorporated legal entity) in a Member State to having a branch in one. The definition of financial institution was likewise quite broad, covering entities ranging from credit institutions and pension funds to investment firms and alternative investment funds.[47] This was clearly an attempt by the Commission to design a 'catch-all' provision to impose the FTT on every possible taxable object and create an unprecedently wide tax base.

[43] Rita de la Feria and Richard Ness, 'The EU FTT as an Unsuitable and Unnecessary Proxy Tax' (2016) 64(2) Canadian Tax Journal 373, 382.
[44] Cédelle and Vella (n 36) 353.
[45] COM (2011) 594, Art. (2)(1)(a). The full definition of financial instrument is provided in Section C of Annex I of Council Directive 2004/39/EC on markets in financial instruments [2004] OJ L145/1.
[46] ibid Art.1(2).
[47] ibid Art. 2(7).

Moreover, the proposal adopted a 'counterparty principle' such that if a financial institution in a third country was party to a transaction with a person established in a Member State, the third-country institution was also deemed to be established for the purposes of the FTT.[48] For example, a US Bank entering into a financial transaction with a German individual, or a US branch of a German bank transacting with an American individual, would both be liable to pay the tax. If both parties are financial institutions established in a Member State, they would be liable to pay the FTT to their respective jurisdictions. If, however, only one of the financial institutions is established in a Member State, they are both still subject to the tax and the non-EU financial institution is deemed to be established by way of the counterparty principle. Both institutions would then pay tax in the Member State of the established party. Accordingly, the nature of the FTT was designed to incentivise more jurisdictions to join in or forego the tax income on both sides of the transaction to an FTT jurisdiction.

Notably, in an attempt to focus the scope of the Proposals and minimise the impact on households and small businesses, transactions on primary markets for securities and currencies were excluded. Similarly, day-to-day financial activities such as lending and borrowing activities of private households and enterprises, insurance contracts, mortgage lending and payment transactions were excluded.[49]

2. *Design of the 2013 Proposals*

The main distinction between the two proposals of the FTT was that the second was driven by a narrower taxable base, consisting of only 11 jurisdictions as well as the legal requirements of the ECP.[50]

The proposal introduced the 'issuance' principle alongside the existing 'residence' principle to tackle Member States' concerns about relocation and avoidance.[51] Any financial institution exchanging a financial instrument issued by a participating Member State would be liable to pay the tax, even if the transaction was carried out by parties that were otherwise deemed not to be established in participating Member States.[52] For example, if a UK bank sold a French bond to a US bank, they would still be liable to pay the tax. As a result, between the 2011 and 2013 Proposals, there was a remarkable broadening of the territorial scope covered

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[48] Cédelle and Vella (n 36) 354.
[49] COM (2011) 594, Art. 1(3)(a).
[50] Marco Greggi, 'A Euro Model for the Tobin Tax? The (possible) impact of the new tax on the European Financial market (and on the Non-EU Investors)' (Tax Research Network Conference, University of Exeter, September 2013) 8.
[51] European Commission, Proposal for a Council Directive Implementing enhanced cooperation in the area of financial transaction tax, COM (2013) 71 Final, s.5.
[52] ibid Art.4(1).

by the FTT, to not only non-participating Member States but also outside the EU itself. The legal issues presented by the extraterritorial scope of these connecting factors will be considered below.

The 2013 Proposal was also bound by the constraints set out by the ECP.[53] While the ECP was introduced in 1997, it was not used until 2010 due to its 'forbiddingly difficult and restrictive conditions'.[54] The procedural requirements of the ECP are as such: the procedure cannot be used with less than nine Member States who must submit a request to the Commission for the further consent of the Council and European Parliament, it cannot be used in an area of exclusive Union competence and must only be used as a last resort. The substantive requirements are that the ECP cannot undermine the internal market, territorial cohesion or distort competition and must respect the rights of non-participating states. Moreover, the use of the ECP hinges on the non-intervention of the non-participating Member States in the implementation of the regulation by participating ones (Art. 327 TFEU).[55]

However, the implications of the FTT were so far-reaching that even the Council of the EU noted that it infringed on the taxing competences of non-participating states, in breach of Article 327.[56] In particular, such an infringement played into fears by many about the 'creeping evisceration of state legislative authority' by virtue of the ever-increasing transfer of democratic power away from domestic legislatures to the EU.[57] Since the introduction of the Lisbon Treaty many Member States have expressed concern about the democratic loss and the transfer of power to the EU which has not been met with an equal increase in democratic legitimacy from Member States.[58] For example, in its decision on the compatibility of the Lisbon Treaty with the German Constitution in June 2009, the German Constitutional Court expressed serious concern about 'maintaining the current structure of the EU as a political entity created and supported by member states, without being a state itself to and prevent its open or creeping transformation into a state'.[59] When it came to the FTT, the Commission did little to allay the fear that 'even the member states' discretionary space and the boundary

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[53] TFEU [2012] OJ C326/47 Arts. 326-334.
[54] De la Feria and Ness (n 43) 378.
[55] TFEU [2012] OJ C326/47 Art. 327.
[56] Legal Service of the Council of the European Union, 'Opinion on a Proposal for a Council Directive Implementing Enhanced Cooperation in the Area of Financial Transaction Tax (FTT) – Legality of the Counterparty-based Deemed Establishment of Financial Institutions (Article 4(1)-point f) of the Proposal', 13412/13, limité (6 September 2013).
[57] Dieter Grimm, 'Defending Sovereign Statehood Against Transforming the Union into a State' (2009) 5 European Constitutional Law Review 353, 371.
[58] See further Christine Neuhold. 'Democratic Deficit in the European Union' Oxford Research Encyclopaedia of Politics (OUP 2020).
[59] Grimm (n 57) 364.

between communitarised and inter-governmental lawmaking [were] now coming under pressure,'[60] especially in an area of law and policymaking as sensitive and central to state sovereignty as tax.

With this in mind, it is unsurprising that the UK challenged the use of the ECP in April 2013.[61] While the CJEU dismissed the case, it highlighted how non-participating states would be subject to the negative spill over of the FTT in their jurisdictions (analysed further below). The FTT forced the EU to reckon with the limits of the ECP, highlighting the extent of the uncertainty that persists around the substantive and procedural conditions of the ECP, including the extent of involvement of non-participating states in the design and discussion of the proposals. While the use of the controversial procedure undoubtedly played a role in the failure of the FTT, it is certainly the case that the FTT was a bad test case for the ECP in the first place.[62] The very nature and design of the tax meant that it was clear from the 2011 proposal, and response, that it would not be smooth sailing for the FTT from the outset.

3. The Connecting Factor Problem

Jurisdiction to tax is 'traditionally analysed according to the doctrine of economic allegiance' and therefore, governments have no jurisdiction to tax 'unless there is an appropriate connecting factor'.[63] For taxes like income and VAT, the connecting factor is based on residence and consumption, both of which are sufficiently robust to compel the payment of these respective taxes with minimal avoidance. It is the presence of a strong, narrowly tailored connecting factor to the activity being taxed that ensures the viability of the tax in the long term.

However, when it comes to FTT, there are three such connecting factors which complicates matters considerably.[64] As highlighted above, the 2011 Proposal utilised the residence principle as its main connecting factor but also adopted the 'place of transaction' principle when read with the provisions of Article 3, taxing transactions occurring in financial institutions headquartered in the EU or otherwise any transaction occurring in a Member State.[65] Article 3(1) of the 2011 Proposal stipulated that a financial institution is considered to be established if 'it has been authorised by the authorities of that Member State to act … in

[60] ibid 371.
[61] Case C-209/13 *UK v Council of the European Union* [2014] EU:C:2014:283.
[62] Cédelle & Vella (n 36) 357.
[63] Peter Harris, *International Commercial Tax* (2nd edn CUP 2020) 61.
[64] Joachim Englisch, John Vella & Anzhela Cédelle, 'The Financial Transaction Tax Proposal Under the Enhanced Cooperation Procedure: Legal and Practical Considerations' (2013) 2 British Tax Review 223, 228.
[65] European Commission, 'Impact Assessment accompanying the document Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax: analysis of policy options and impacts' Staff Working Document (SWD) (2013) 28 Final, s.6.4.1.

respect of transactions covered by that authorisation'.[66] Since financial institutions outside of the EU require authorisation to trade on European trading platforms, they are deemed to be established for the purposes of the FTT. Together these two principles catch all taxable transactions occurring within the EU. The last connecting factor was the addition of the issuance principle in the 2013 Proposal, taxing financial instruments issued by EU Member States. The existence of not one but three connecting factors is indicative of the kitchen-sink approach of the EC in its design of the FTT. But more importantly, it suggested that each connecting factor was not strong enough on its own to enforce on its target tax base, lacking the relevant and genuine economic link necessary to make it economically viable.

Moreover, it should be noted that in *Air Transport Association of America v Secretary of State for Energy and Climate Change*,[67] the CJEU has confirmed that customary international law is binding on institutions of the EU (as per Article 3(5) TEU)[68] and any secondary legislation that fails to conform to customary international law is void. Under customary international law principles, states can inherently exercise their prescriptive jurisdiction within their territory but can only exceptionally do so extraterritorially. [69] States must show 'a degree of moderation and restraint in the exercise of their sovereign powers' if they wish to exercise their jurisdiction extraterritorially, especially if the exercise of such jurisdiction would infringe upon the sovereignty and territorial rights of other states.[70] As such, when exercising their prescriptive jurisdiction extraterritorially, the connecting factor acts as the basis for their jurisdiction and subsequently must be substantially connected to the jurisdiction either through their territory ('territoriality principle') or their nationals ('personality principle').[71] EU secondary legislation must conform to these limits and this has clear implications on the jurisdiction to tax.

Taxes that are difficult to enforce extraterritorially indicate a lack of sufficiently close connection to the jurisdiction and risk infringing on the 'sovereign rights of other states that have a close(r) nexus' to the respective taxpayers.[72] The need for a relevant and definite connecting factor that binds the tax to the jurisdiction, therefore, cannot be emphasised enough.

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[66] COM (2011) 594, Art. 3(1).
[67] Case C-366/10 *Air Transport Association of America and Others v Secretary of State for Energy and Climate Change* [2012] 2 CMLR 4, paras 101–102.
[68] TEU [2012] OJ C326/13.
[69] See *The Case of the SS Lotus* (France v Turkey) (1927) PCIJ Series. A No.10, (1927), at 18-19 and James Crawford, *Brownlie's Principles of Public International Law* (9th edn, OUP, 2019), 462-464.
[70] Englisch, Vella, and Cédelle (n 64) 238.
[71] See more in *The Case of the SS Lotus* (France v Turkey) (1927) PCIJ Series. A No.10, (1927), *Brownlie's* (n 69) 442-446.
[72] Englisch and others (n 64) 239.

The connecting factor must pass the 'genuine link' test which evaluates whether there is a significant and genuine link between the tax and jurisdiction by assessing not only the ambit but also the object and purpose of the tax. Although the residence and place of transaction principles are sufficiently compatible with EU and customary international law, the counterparty and issuance principles extended the extraterritorial reach of the tax beyond its lawful scope by infringing on the taxing rights of non-FTT jurisdictions.[73] The failure of the EC to keep the FTT within the limits of customary international law underscores that the failure of FTT came down to poor design.

a) The Residence and Place of Transaction Principle

The international law effects of the residence principle are straightforward enough. The territorial presence of persons, natural or legal, is a sufficiently relevant link to 'regulate and also tax their activities even beyond national borders'.[74] Financial institutions that are deemed to be established in participating Member States can also be liable to taxation due to the personality principle. Similarly, the place of transaction principle also passes the 'genuine link' test because 'economic activity that takes place within the state's territory … justifies the corresponding tax liability, irrespective of any territorial connection of the acting person'.[75] These principles also square well with the policy aims of the tax. Indeed, financial institutions resident in a participating jurisdiction would have benefitted from public spending during the financial crisis and relied on the financial services infrastructure in these jurisdictions to conduct business. Consequently, it is warranted that these institutions should form the core of the tax base for the FTT to ensure that they do indeed contribute a fair share to the revenue of Member States.[76]

There is one problematic aspect of the residence principle – the extension of establishment to a counterparty. When one party to the taxable transaction is established in a participating Member State, the counterparty financial institution will also be deemed to be established in that State and therefore liable for the FTT.[77] However, it is extremely unconvincing that financial institutions should become liable to pay the FTT or contribute to revenue just because the counterparty is based in a participating Member State. Since there is already FTT liability for the resident involved in the transaction, the 'extraterritorial contagion

[73] Legal Service Opinion (n 56) para 42.
[74] Englisch, Vella, and Cédelle (n 64) 240.
[75] ibid.
[76] ibid.
[77] COM (2013) 71, Art. 4(1)(f).

effect' of the tax on a counterparty is contrived, problematic and unnecessary.[78] The Legal Service of the Council likewise questioned why third country financial institutions that had no part in the crisis should be held liable for the costs.[79] The opinion further opined that the jurisdiction of their establishment would have a better claim and closer territorial nexus to that revenue anyway.[80]

b) The Issuance Principle

The issuance principle remains the most problematic aspect of the FTT, as it breached customary international law by bringing ordinary transactions which were too remote into the ambit of the FTT and does not pass the genuine link test. While the overall FTT proposals aimed to compensate Member States for the financial crisis and under-taxation of the financial services sector, the introduction of the issuance principle only ever had one aim: to target tax avoidance. However, it is unconvincing that a transaction between two financial institutions should contribute fairly to the cost of the financial crisis in a jurisdiction in which they do not operate just because the instrument being exchanged is issued by a participating Member State. Nor would these transactions attract a VAT, [81] even if financial services were subject to VAT because the link between the consumption of said financial product would be too remote from the tax jurisdiction.

The other aim of the FTT, to disincentivise high-frequency trading which disrupts the efficiency of financial markets, also does not apply to this principle. High-frequency trading primarily affects stock markets, but the issuance principle covered the same breadth of financial transactions as the residence principle. It would therefore be ineffective at preventing the harmful effects of high-frequency trading in third countries since it would only cover a handful of these stocks.[82] Moreover, in the US, European stocks are traded in the form of depositary receipts issued by a US bank and would not be caught by the issuance principle anyway, making the connecting factor highly ineffective where it matters the most.

The issuance principle is also paradoxical in its primary objective. The Commission's intention was to target tax avoidance that relocates financial activity offshore. However, in doing so, the EC hoped to neutralise the negative territorial effects caused directly by its own tax proposal. The public international law effects of this are clearly impermissible since the extraterritorial effects of the tax 'merely on the grounds of neutralising the negative territorial

[78] Englisch, Vella, and Cédelle (n 64) 240.
[79] Legal Service Opinion (n 56) para 21.
[80] Legal Service Opinion (n 56) para 21.
[81] Englisch, Vella, and Cédelle (n 64) 241.
[82] ibid 242.

effects' are not acceptable and the 'mere promotion of national economic policy objectives does not constitute a sufficient link by the standards of public international law'.[83] Therefore the extraterritorial enforcement reach of the FTT due to the issuance principle makes it incompatible with customary international law.

In this regard, the Commission made two main arguments: that the issuance principle corresponds to the destination principle in VAT and by comparison to the UK's Stamp Duty Reserve Tax (SDRT).[84] These comparisons simply do not hold up. For one, VAT is linked to consumption which forms the relevant and genuine economic link to the tax. Under the destination principle, VAT is paid at the final point of consumption rather than at the origin of the product.[85] The connecting factor for VAT is therefore sufficiently robust because if the traded good is consumed, it can rightfully be taxed at that point. Moreover, the destination principle accords VAT a certain level of 'neutrality' in international trade since all goods are taxed domestically at the same rates and the revenue goes to the taxing jurisdiction without disagreement.[86] This is not the case with the issuance principle where there is a strong mismatch between the place of consumption and the receiver of the revenue which may be a participating Member State with no territorial connection to the transaction.

The Commission's comparison to SDRT is also questionable at best. SDRT is indeed based on the issuance principle and one that has been widely accepted by other states. SDRT is chargeable on the purchase price of a share in a UK incorporated company where there is a legal instrument of transfer.[87] More importantly, liability for SDRT arises regardless of where the transaction takes place and therefore relies heavily on the issuance principle for its payment. There are, however, two significant points of divergence. Firstly, the SDRT is a product of historical development from the 17th century, evolving from a tax on the instruments needed for the sale or transfer of shares to a tax on the use of domestic electronic share transfer systems. The UK government has also created exemptions for overseas exchange-traded funds and exempts securities issued by companies incorporated overseas but traded in the UK. Therefore, the number of overseas transactions actually caught by the SDRT are low and somewhat

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[83] ibid.

[84] See Commission Memo 13/98, 'Financial Transaction Tax through Enhanced Cooperation, Questions and Answers' (14 February 2013).

[85] 'International VAT/GST Guidelines on Neutrality', Organisation for Economic Cooperation and Development (OECD), Committee on Fiscal Affairs, (2011). <https://www.oecd.org/ctp/consumption/guidelinesneutrality2011.pdf> Accessed 1 May 2021.

[86] ibid.

[87] Mike Hawkins & Julian McCrae 'Stamp Duty on Share Transactions: Is there a case for change?' (2002) The Institute for Fiscal Studies (2002) <https://www.ifs.org.uk/comms/comm89.pdf> Accessed 1 May 2021.

unobjectionable.[88] Secondly, the SDRT can be justified by the territoriality principle because it levies a tax on the location of capital investment, albeit intangibly, and this can reasonably be expected by domestic institutions.[89] On the other hand, the FTT is a general tax on the financial services sector. As such, the lack of substantial connection between the jurisdiction of the companies whose shares are traded and the jurisdiction where the tax liability arises make it difficult to justify the FTT by way of the SDRT. Instead, SDRT would be more comparable to the 'place of transaction' principle since it covers many of the same scenarios and as such, the comparison to SDRT, or any other national FTT, is rather artificial.[90]

Article 4(3) of the 2013 Proposal provided an escape clause, under which a taxable person would not be liable for the payment of the FTT if they could prove 'that there is no link between the economic substance of the transaction and the territory of any participating Member State'.[91] Nevertheless, commentators have raised serious doubts about the suitability of this clause as a safeguard for keeping the extraterritorial effects of the issuance principle in check because it puts the onus entirely on the taxpayer.[92] The EC's failure to keep the scope of the FTT within the limits of the customary international law and the well-established principles of territoriality are further evidence, therefore, that the failure of FTT came down to design.

4. Anti-avoidance Mechanisms

A significant design change between the 2011 and 2013 Proposals was the introduction of anti-avoidance provisions in the form of a General Anti-Abuse Rule (GAAR) as a way of making the FTT more robust. While the EC remained positive about the 2011 Proposal's 'broad base and powerful anti-relocation, anti-evasion and anti-avoidance features', participating Member States still harboured serious concerns.[93] As the Swedish example highlighted, one of the biggest flaws of FTTs is that poor design can make the tax particularly susceptible to avoidance. More importantly, the residence principle does not work well for legal persons especially in the current era of tax competition since MNEs already utilise aggressive tax planning to avoid burdensome taxing regimes. The problem becomes more acute when financial instruments are involved since they are fungible and regardless of attempts to address definitional issues in the directives, tax avoidance through substitution using new instruments remained a significant problem. FTT anti-avoidance therefore needed to target these grey areas. These fears were

[88] Englisch, Vella, and Cédelle (n 64) 243.
[89] ibid.
[90] ibid 244.
[91] COM (2013) 71, Art. 4(3).
[92] Englisch, Vella, and Cédelle (n 64), 244; Legal Service Opinion (n 56) para 25.
[93] SWD (2013) 28, 50.

compounded by the ECP which allowed differentiated integration between EU Member States and would make it even easier for financial institutions to pivot around the tax by shifting their operations to a non-participating Member State due to the EU's fundamental freedoms of capital and establishment.

A GAAR 'is composed as a broad rule based on general principles to counter potential avoidance of [a] tax'.[94] The 2013 Proposal used a previous Commission Recommendation against aggressive tax planning as the basis for the FTT GAAR but expanded the scope so much so that 'it reads like a roll call of every concept used in anti-avoidance provisions'.[95] Although GAARs are meant to be broad, the multiplicity of concepts in no way enhances the robustness of a GAAR and nor does it make it easier to apply. Tax academics have called the tests and mechanisms employed by the FTT GAAR 'questionable'.[96] For example, the GAAR attempts to recharacterise transactions according to their economic substance, but this is not necessarily straightforward when it comes to intangible financial transactions. The full scope of the GAAR is not well-defined either. For example, an over the counter (OTC) derivative purchased by a US bank is effectively a substitute for the purchase of a share of a company from a participating Member State, but it is not clear if the GAAR would catch such avoidance.[97] If it does indeed catch this type of avoidance, then extra-territorial enforcement would be an added problem. Most importantly, the GAAR would not catch the relocation of companies from participating Member States or the conversion of branches outside participating jurisdictions to subsidiaries, possibly the two biggest sources of FTT avoidance. Therefore, the robustness and efficacy of the GAAR must be seriously questioned.

The introduction of the GAAR was complemented by the issuance principle, whose primary function was to catch transactions that were moved offshore to avoid the FTT. On closer inspection, the issuance principle in fact goes 'far beyond its anti-avoidance justification' by bringing ordinary transactions completed unrelated to FTT avoidance within the scope of the tax thereby becoming 'tantamount to the introduction of a new tax'.[98] For example, transactions of a German bond between a US bank and a Singaporean Bank would be subject to the FTT despite having no other substantial connection to the jurisdiction. As highlighted above, the scope of the issuance principle cannot be justified by its anti-avoidance objective.

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[94] PWC, General Anti-Avoidance Rule <https://www.pwc.com/cz/cs/danove-sluzby/danova-politika/assets/gaar-general-anti-avoidance-rule-en.pdf> Accessed 1 May 2021.
[95] Englisch, Vella, and Cédelle (n 64) 226; Commission Recommendation on aggressive tax planning, C (2012) 8806 final.
[96] Englisch, Vella, and Cédelle (n 64) 227.
[97] ibid.
[98] ibid 229.

Alongside these anti-avoidance measures the 2013 Proposal closed certain loopholes that had existed in the 2011 Directive. These changes included the introduction of a targeted anti-avoidance rule to prevent the abusive use of depositary receipts and counting the exchange of a financial instrument as two financial transactions to avoid tax circumvention.[99]

5. *Impact of the FTT on Participating Member States*

The benefits for the participating Member States were rather straightforward, at least in the eyes of the Commission. Member States could expect a positive impact through the attainment of the FTT's desired objectives (which will be evaluated in Section D).

Critics of the tax, however, included tax academics and several state institutions such as the German, French and Dutch Central Banks and the House of Lords.[100] They pointed to several potential negative effects of the FTT including a reduction in real Gross Domestic Product (GDP), increase in the cost of government borrowing, increase in the cost of capital, reduced liquidity in the financial markets and relocation of entities and activities.[101] A City of London study on the impact of the FTT projected that 'with a typical 10 transactions in the chain of settlement for bonds, cascading could convert the 0.1% draft EU rate on bond transactions into an effective tax rate of 1.0%' because it would be chargeable on each transaction in the chain.[102] Therefore, the real impact of the FTT would be higher than anticipated.

Significantly, there was a concern that the tax would be passed on from financial institutions to their clients, instead of the lucrative financial sector where the burden was meant to fall. In practice, financial institutions carry out transactions for everyone, from pension funds to life insurance funds, so the average citizen with capital would be affected. In fact, a UK based consulting firm estimated that a 0.2% FTT could reduce pension fund values by more than 5% and reduce annual returns by 0.2%.[103] Nonetheless, this is consistent with the tax's function as an indirect tax on the consumption of financial services.

One of the most burdensome negative effects was the issue of double taxation, arising due to the conflict of connecting factors between the FTT and a localised FTT like the SDRT. For example, if a German bank and a French bank trade the shares of a British company, the FTT would be due in France and Germany as well as the SDRT in the UK.[104] It is hard to

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[99] COM (2013) 71, Arts. 14; 2(2).
[100] See European Union Committee, *Towards a Financial Transaction Tax?* (HL 287 2010-11).
[101] Cédelle and Vella (n 36) 358.
[102] Burman and others (n 2) 196.
[103] Oxera Consulting Ltd, 'What Would Be the Economic Impact of the Proposed Financial Transaction Tax on the EU?' (2011), 23.
[104] Englisch, Vella, and Cédelle (n 64) 230.

estimate how many such transactions would be affected because the EC states that they would 'constitute only a tiny fraction of transactions for which the common system of FTT is designed'.[105] However, there would be a need to reassess double taxation conventions (DTCs), which are intended to protect MNEs and individuals against situations like this where two or more jurisdictions claim the right to tax the same transaction or occurrence. Bilateral DTCs are often individually negotiated by Member States with each other or with third countries.
In light of the new tax burden, which would have affected participating and non-participating Member States considerably, DTCs would have to be renegotiated to include the FTT.

6. Impact of the FTT on Non-Participating Member States

The impact of the FTT on non-participating Member States in the 2013 Proposal is one of the most contentious aspects of the tax. However, the Commission's 2013 Impact Assessment does not include a comprehensive overview of the consequences for non-participating Member States and instead includes disjointed observations about what the impact could be.

The fact that the EC did not seriously consider the impact on non-participating Member States serves as further evidence that the FTT was ill-considered and ill-conceived. To a certain extent, it undermines the legitimacy of the ECP by infringing on non-participating Member States' rights without a comprehensive assessment and hinders the likelihood of multilateral tax cooperation through such means again. Moreover, it raises serious concerns about the EC's hopes that more Member States would join once the benefits were made clear to them because the full impact of non-participation was not assessed.

As a result of the ECP, non-participating Member States, would effectively be treated like third countries for the purposes of the FTT. To a large extent, financial markets in London and Hong Kong would be similarly affected by the tax. Nevertheless, the impact on non-participating Member States would be much more acutely felt by virtue of the economic conditions created by the EU internal market.

The negative impact of the FTT on non-participating Member States need not be overstated. The first possible negative impact is the discrepancies between participating and non-participating Member States' financial institutions, which could potentially lead to reduced profits and increased costs in the non-participating Member States. For example, if a UK bank transacts with a French bank, the FTT paid by the UK bank may be deductible for corporate tax purposes, but the FTT is still payable to the French government, resulting in a

[105] SWD (2013) 28, 17.

reduction in corporate tax revenues in the non-participating Member State.[106] As mentioned above, there is also an issue of double taxation in certain cases.

Similarly, the FTT would impose a costly burden on non-participating Member States including increased costs for government borrowing, of collecting the tax (the mechanism for which was not specified in the proposals), and further negative fallout from changes in financial activity.[107] Further, it is likely that the general public would have borne the brunt of the tax as the cost of the FTT as the higher tax burden of large financial institutions nay be passed on to their consumer banking wings. Simultaneously, the increased administrative cost would come at the expense of the average citizen, through reallocation of government expenditure or the levying of higher domestic taxes. Consequently, the FTT would create a lose-lose situation for non-participating Member States, who would be forced to collect the tax, whose financial institutions would have been subject to the tax and whose citizens lose out by being the end payer of the FTT, only for the benefit of that income to go to an FTT jurisdiction.

The 2013 Impact Assessment by the EC was aware of these issues but chose to portray them as an opportunity for positive changes in the financial markets. The Assessment notes that the FTT might increase the cost of capital in non-participating Member States but that this 'should at most be a fraction of the (already rather tiny) assumed increase in the costs of capital in the EU11+'.[108] Similarly, the EC acknowledges that there might be increases in transaction costs for financial institutions in non-participating Member States but presents these as an opportunity to 'deflat[e] excessive market volumes, reduc[e] the share of high-frequency trading', reduce the frequency of risk hedging operations and expected that the overall rate of return on individual transactions should still remain positive.[109] The positive gloss of 'opportunities' here is not entirely convincing. For one, deflating excessive market volumes begs the question of what the EC defines as 'excessive'. Moreover, the existing economic evidence on curbing high-frequency trading to improve market efficiency is inconclusive since it is highly dependent on several dimensions such as substitution across financial and quasi-financial instruments and casts doubts on the FTT's purported regulatory function.[110]

Nevertheless, there are several positive effects of non-participation for Member States that should not be ignored. In particular, the Impact Assessment recognised that 'it is

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[106] Cédelle and Vella (n 36) 359.
[107] ibid.
[108] SWD (2013) 28, 46.
[109] ibid 46-47.
[110] See more Maria Coelho, 'Dodging Robin Hood: Responses to France and Italy's Financial Transaction Taxes' University of California, Berkeley (2016) < https://ssrn.com/abstract=2389166> Accessed 1 May 2021.

unavoidable that the FTT will lead to a diversion of institutions, activities and capital from participating Member States to non-participating Member States'.[111] For example, financial institutions might set up subsidiaries in non-participating Member States or convert branches in participating Member States into subsidiaries.[112] These subsidiaries would be exempt from the FTT on transactions with third country financial institutions, as long as they do not transact using a financial instrument issued in a participating jurisdiction. The benefits of this are clear. A French bank that transacts regularly with institutions in New York would benefit considerably from carrying out these transactions from a subsidiary based in London given the cumulative cost of the FTT over high transaction volumes.[113] The financial institutions in participating Member States may also choose to move their headquarters to non-participating states. This would circumvent the FTT under both the residence and counterparty principles. Thus, in the long term, non-participating Member States may have gained from the relocation of entities and activities and their ability to attract capital that would have otherwise flowed through participating Member States. In fact, non-participation could have given these jurisdictions a significant competitive advantage by becoming an FTT tax haven. These issues underscore the need to use the EU architecture in its totality in order to get the FTT through. Use of the ECP or anything less than total harmonisation opens the FTT up significant loopholes.

Given the failure of the proposals and the lack of a full impact assessment from the EC, it is difficult to tell what the overall net effect of the FTT would have been on non-participating states. Commentators have also been hesitant to estimate the size of the potential gains by non-participating states but expected them to be significant.[114] The non-participating Member States with the most developed and economically significant financial sectors stood to lose or gain the most, but it is unlikely that these states would have been happy to gamble on the uncertainty.

7. Revenue Generation

To truly judge the effectiveness of the FTT, we must also put the revenue raising objectives that are intrinsic to the proposals into perspective. The initial impact assessment of the FTT by the EC estimated that revenue could vary from €25 billion to €45 billion at the 0.1% rate on securities and 0.01% on derivatives.[115] However, in the proposal itself, the EC estimated that the FTT could deliver up to €57 billion worth of revenue, if implemented across the EU with

[111] Cédelle and Vella (n 36) 360.
[112] SWD (2013) 28, 42-3.
[113] Englisch, Vella, and Cédelle (n 64) 232.
[114] ibid.
[115] SEC (2011) 1102, 47.

approximately €19.4 billion from the securities and €37.7 billion from derivatives.[116] This figure was proposed as a reasonable, aggregate estimate, taking into account transactions carried out in a third country that would be subject to the FTT through the residence principle (which were not included in the original estimate) and that some transactions may be carried out by a European agent on behalf of a non-European party leading to overestimations of revenue.[117] It is important, however, not to take these figures at face value because the EC noted that estimating revenues for the FTT 'is not feasible without a high degree of uncertainty'.[118] Furthermore, operating in conditions of Knightian uncertainty, where the information needed to accurately determine and allocate the probabilities of risk cannot be properly ascertained, made the FTT a much bigger gamble than the EC perhaps realised in its initial impact assessment.[119]

Naturally, these estimates were reduced in the 2013 Proposal to approximately €31 billion across 11 Member States, especially given that the Member States with the most developed financial services sectors would be excluded.[120] However, once again these figures are not entirely reliable because the Commission utilised proxies to scale down the 2011 estimates by the banking sector's net operating income for the participating Member States. The uncertainty around the estimates due to the use of proxies weakens the argument for implementation – why should Member States sign up if the main revenue objectives cannot be guaranteed? The Commission expected that the issuance principle would catch a further 10% of financial transactions and raise '€0.38bn from taxing shares and €0.83bn from taxing bonds'.[121] The minimal tax revenue from the introduction of the issuance principle raises serious questions about whether the principle was even necessary for such a meagre rise in revenue. Moreover, the result of tax competition and avoidance means that revenue generated by the FTT could be even lower than the Commission expected as activity moves out of FTT jurisdictions.

Furthermore, the economics of the tax also do not support the estimates of revenue that the EC was expecting from the FTT. At best the €31 billion figure is extremely optimistic, given the tax avoidance and competition issues raised in this essay. National FTTs have shown

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[116] SWD (2013) 28, 21.
[117] ibid 21-22.
[118] SEC (2011) 1102, 46.
[119] Peter Dizikes, 'Explained: Knightian uncertainty' (*MIT,* 2 June 2010) < https://news.mit.edu/2010/explained-knightian-0602> accessed 9 June 2022; See more Mark D Packard, Per L Bylund & Brent B Clark, 'Keynes and Knight on uncertainty: peas in a pod or chalk and cheese?' (2021) 45(5) Cambridge Journal of Economics 1099
[120] SWD (2013) 28, 23.
[121] ibid 40-41.

that 'vast amounts of revenue – 1 percent of gross domestic product or more – is inconsistent with actual experience'.[122] Sweden raised just 5% of the original estimated annual revenue at the peak of its FTT revenue.[123] The French FTT has raised only 44% of the expected revenue while the Italian FTT, introduced in 2013, has collected only 20% of its initial estimated revenue.[124] Even in the 2011 Proposal, the Commission did not expect to generate annual revenue of more than '0.13 to 0.35% of GDP in the participating countries'.[125] To put the revenue-raising in context, the UK's SDRT typically raises about £3 billion per year accounting for 0.6% of the UK's total tax revenues.[126]. The revenue per Member State will also vary based on the size of the financial sector in each jurisdiction, with countries like France and Germany raising more than Slovenia for example. While the figures are by no means negligible, the concerns about tax avoidance and the difficulties of EU harmonisation begs the question of whether the cost of implementation of the FTT is worth the approximately €2.8 billion per Member State it would raise.

D. THE FAILURE OF THE FTT AND WIDER POLICY IMPLICATIONS

1. Unfit for Purpose: the FTT's Objectives

Indeed, the FTT's design played an outsized role in its ultimate failure. Beyond the aforementioned flaws in the tax, the proposals were also unsuitable to achieve the Commission's stated objectives. As a reminder, the FTT objectives were to raise revenue from the financial sector and compensate for the under-taxation of financial services due to VAT exemption, disincentivise transactions that do not enhance the efficiency of financial markets, avoid the fragmentation of the internal market caused by uncoordinated tax measures and demonstrate how an effective FTT can be designed and implemented beyond the EU. Doubts have already been raised earlier in this essay about the Commission's revenue estimates as well as on whom the final tax burden would fall (most likely not the institutions that the FTT was trying to target).

Moreover, under-taxation of financial services due to the VAT exemption is a serious issue but the extent to which the VAT provides a tax advantage for the financial sector is 'an

[122] Burman and others (n 2) 173.
[123] ibid 178.
[124] De la Feria and Ness (n 43) 383.
[125] Burman et al (n 2) 179.
[126] ibid 175; SDRT raised £3.52 billion between 2019-20 UK Stamp Tax Statistics 2019 to 2020 – Commentary, HMRC < https://www.gov.uk/government/statistics/uk-stamp-tax-statistics/uk-stamp-tax-statistics-2019-to-2020-commentary> Accessed 1 May 2021.

unsettled empirical question' with rough estimates ranging from 0.11% to 0.17% of GDP.[127] To that end, the EC itself noted that 'transaction taxes… are not really effective to compensate for the VAT exemption' currently enjoyed by the financial sector and therefore only go part of the way in solving the problem.[128] Moreover, the FTT exempted bank deposits and loans from the tax base, a major part of the exemption, and so would not capture the value-added sufficiently.[129] Nor does the FTT have the same level of neutrality or anti-cascading benefits as VAT. Even if one believes, like De la Feria, that an extension of VAT to financial services would 'better address the existing gap in the VAT base' than the FTT, the result remains the same: the FTT is still not the best tax instrument available.[130]

In 2011, the Commission suggested that the revenue from the first proposal could be used to contribute to the EU Budget to replace certain resources that are currently paid out of national contributions.[131] The EC proposed that approximately 2/3 of the revenue should go to the EU Budget and 1/3 to the Member States.[132] Similarly, in 2013, the European Council once again invited participating Member States 'to examine if the FTT could become the base for a new own resource for the EU Budget'.[133] The former Advocate General Miguel Maduro argued for an increased EU budget to be raised through contributions from increased taxes like the FTT, claiming that the 'taxes are justified because the economic activity was made possible by the internal market, or because the economic activity, while taking place within a state, has externalities for other Member States, or because it is an economic activity that states can no longer tax on their own'.[134]

This implication raises questions about the use of FTT revenue. If the aim of the tax is to ensure that the financial sector pays its fair share, it makes little sense for that revenue to go to the EU Budget instead of the treasuries of Member States. Nor does it help Member States pay off the debt that they accumulated during the financial crisis. While the EU hoped that the FTT would reduce Member States' individual contributions, the volatility and uncertainty around the tax could easily vary revenue from one year to the next and would not be a stable

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[127] SEC (2011) 1102, 14.
[128] ibid 34, s.6.2.
[129] ibid.
[130] De la Feria and Ness (n 43) 384.
[131] SEC (2011) 1102, 12.
[132] Christiana Panayi, *Advanced Issues in International and European Tax Law* (Hart Publishing, 2015) 291.
[133] COM (2013) 71, 15.
[134] Paul Craig, 'Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications' in M Adams, F Fabbrini and P Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Hart, 2014); see further Miguel Maduro, 'A New Governance for the European Union and the Euro: Democracy and Justice', European Parliament, Directorate-General for Internal Policies, Policy Department C: Citizens' Rights and Constitutional Affairs, PE 462.484 (2012).

enough source of funding without the need for top-ups from Member States. Moreover, Member States have vastly differing financial sectors and so a high percentage of revenue may have been generated from some over others. This fear was palpable in the UK where the House of Lords raised concerns about the fact that FTT revenue collected from UK financial institutions would reduce the national contributions of a participating Member State at the expense of the macro-economic effects on the UK.[135] The question of creeping competences of the EU was once again at play here – the fact that national control over fiscal policy as well as large sectors of the domestic economy could be lost to the EU in a process unsubstantiated by democratic legitimacy was deeply troubling to non-participating Member States. Given that Member States would have to repeal their national FTTs in favour of the EU-wide measure, the allocation of the revenues is even more important and remained unresolved in both proposals. Similarly, the objective of 'creating appropriate disincentives for transactions that do not enhance the efficiency of financial markets' was directed at high-frequency trading, but the existing evidence of using tax to perform a regulatory function is inconclusive (as pointed out above) and the impact of such trading on market efficiency is still debatable even by the Commission's own admission.[136] An FTT would not target the causes of the 2008 financial crisis, such as excessive leverage and insufficient liquidity, and these practices are better targeted through regulation.[137]

The next objective, of avoiding fragmentation of the internal market resulting from an uncoordinated approach, is perhaps one of the most pressing objectives as it forms the legislative basis for the FTT under Article 113. Since the 2011 Proposal, several Member States including Spain, Italy and France have introduced their own FTTs. However, since the ECP would only harmonise FTTs in the EU11 and excluded eight national FTTs in non-participating jurisdictions, it is not evident that the level of distortion would be reduced.[138] In fact, the ECP would deepen distortion by only partially integrating the tax regimes of certain Member States and not others. Moreover, the EC claims that the non-harmonisation of FTTs would lead to tax arbitrage and potential double taxation.[139] However, it has been demonstrated in Section C that

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[135] Letter from House of Lords European Union Committee Letter to Greg Clark MP, dated 16th April 2013, 4, <https://www.parliament.uk/globalassets/documents/lords-committees/eu-sub-com-a/FTTEnhancedScrutiny/260313FTT.pdf.> Accessed 1 May 2021.

[136] See Maria Coelho (n 110); Thomas Hemmlegarn and others, 'Financial Transaction Taxes in the European Union' (2016), 69(1) National Tax Journal 217-4; European Commission, 'Public consultation: review of the markets in financial instruments directive (MiFID)' (8 December 2010) 14.

[137] See European Parliament and Council Directive 2014/65/EU of 15 May 2014 on markets in financial instruments (MiFID) II, [2014] OJ L173/349.

[138] Englisch, Vella, and Cédelle (n 64) 251.

[139] COM (2013) 71, s.3.2.

these issues arise even with the EU-wide FTT and are exacerbated by the ECP. At the time of the proposals, some scholars also questioned whether the FTT would violate the EU freedoms, especially jeopardising the free movement of capital in participating jurisdictions by imposing additional costs on financial transactions.[140] These fears have been allayed by the CJEU's decision in *Société Générale v Agenzia delle Entrate*,[141] in which the Italian branch of the French bank Société Générale brought a claim arguing that the Italian national FTT was in breach of Article 18 (non-discrimination), 56 (freedom to provide services) and 63 (free movement of capital) TFEU. The tax applied to transactions of derivatives, if the underlying securities are issued by an Italian company, regardless of the place of residence or transaction. The CJEU ruled that Italy's national FTT does not breach free movement of capital because the tax was non-discriminatory in its application, applying to resident and non-resident taxpayers.[142] While it is likely that the same would hold true for an EU-wide FTT, it may require the Court to do more heavy lifting to justify its conclusion and override a competence traditionally exercised exclusively by Member States, adverting to 'greater teleological input' instead of simple textual treaty provision analysis.[143]

Within the framework of EU law, the FTT also raises questions over proportionality, which requires that Union action be assessed on its suitability and necessity to ensure that it does not exceed what is necessary to achieve the objectives of the Treaties.[144] This essay has already shed a certain amount of light on the suitability issues. The design issues highlighted above go part of the way to showing that the FTT was highly unsuitable as a tax. The other half is demonstrated by the FTT's unsuitability to meet its intended goals in almost every regard. Subsequently, the measure also breaches proportionality but when combined with the 'perils of partial integration' the FTT becomes even more destructive.[145] The ECP would have allowed the FTT to 'circumvent principles of … good governance in the European Union' by side-stepping the unanimity requirement for tax harmonisation.[146] Therefore, a bold project like the FTT should not have been introduced through the ECP in the first place – a procedure which itself is still controversial in the EU.

2. *The FTT as a Model for Tax Multilateralism*

[140] González-Barreda (n 42) 224.
[141] Case C-565/18 *Société Générale. v Agenzia delle Entrate – Direzione Regionale Lombardia Ufficio Contenzioso* [2020] ECLI:EU:C:2019:1029.
[142] ibid [33]-[34].
[143] Paul Craig, 'Pringle: legal reasoning, text, purpose and teleology' (2013) Maastricht Journal of European and Comparative Law 20(1) 3, 10
[144] TEU [2012] OJ C326/13, art.5(4).
[145] Panayi (n 132) 302.
[146] ibid.

The FTT's last objective, to demonstrate how an effective FTT can be designed and implemented beyond the EU, has become almost ironic considering the proposals failed to be passed. Typically, in the EU there has been a 'strong and entrenched tradition of deference to Member States' sovereignty and as such, the right to tax is fiercely guarded by Member States, who see tax as the core of that sovereignty.[147]

The experience of the FTT highlights exactly why tax multilateralism is increasingly important in the international tax order. The reality of tax competition is such that the tax sovereignty of states has been considerably weakened, with some academics even going as far as saying it is a myth.[148] In fact, as a consequence of tax competition 'states are actually unable to set their tax policies independently of others' and so, are fiscally interdependent.[149] This is clearly demonstrated by the FTT, where highly mobile and substitutable financial instruments make avoidance extremely easy but 'international cooperation and coordination of tax bases and rates could greatly reduce the scope of tax avoidance'.[150] The fact that the Commission felt the need to introduce the issuance principle and a GAAR to combat FTT avoidance underscores how non-participation can actually be an incentive for jurisdictions to 'reap the potential economic rewards associated with being [an] FTT tax haven' and keep furthering tax competition all the way to the bottom.[151] If states adopted a coordinated approach to taxes like the FTT, they would ensure that there was no way of escaping the tax and could reap high revenues with minimal negative effects.

Political Economists like Dani Rodrik have theorised a 'trilemma' between international economic integration, the nation-state, and mass politics, of which any two objectives can be achieved.[152] But notions of sovereign control over economic policy are, to some extent, an illusory myth already – in our current globalised economy, international economic integration has already begun to take place through organisations like the WTO and OECD that coordinate trade and tax policy respectively. The current overarching goal of nation-states is to 'appear attractive to international markets' and consequently tax policies are set in a competitive manner, dictated more so by what other states are doing instead of

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[147] ibid.

[148] Tsilly Dagan, 'Tax Sovereignty in an era of Tax Multilateralism', in Dennis Weber (ed) *Era of Tax Multilateralism in EU Law and the Building of Global Supranational Tax Law: EU BEPS and State Aid* (IBFD April 2017) 39.

[149] ibid.

[150] Burman and others (n 2) 185.

[151] ibid.

[152] Dani Rodrik, 'How far will international economic integration go?' (2000) Journal of Economic Perspectives, 14(1), 177, 180.

immediate domestic need.[153] This 'Golden Straightjacket' as theorised by Thomas Friedman, sees economies grow at the expense of domestic control over politics – once put on, there is no room for any major deviation from the core golden rules, leaving only room for slight nuances in politics to account for the national character of the state.[154] In 2000 Rodrik prophesised that 'an ongoing series of financial crises will leave national electorates sufficiently shell-shocked that they willingly, if unhappily, done the Golden Straitjacket for the long run'.[155] Indeed, this is where we find ourselves now – having endured a long and painful recovery from the 2008-9 financial crisis, followed by the COVID-19 crisis and now staring down the barrel of unprecedented levels of inflation.

However, the alternative is global federalism in which states would have relationships akin to the US state and federal government model. Over the last two decades, the EU has come to a embody the closest model to the global federalism that Rodrik theorises as an alternative to the straitjacket capable of facilitating further international economic integration. This is what makes the EU such an interesting 'playground' in which to experiment with supranational tax law and reap the benefits of tax cooperation instead of competing. Within the ambit of the EU, Member States effectively 'check' their sovereignty upon joining but are nevertheless offered an (albeit deficient) sense of democratic legitimacy that the OECD does not provide. They accept the primacy of EU law and the limitations on sovereignty that come with it. At the same time, the EU Treaties safeguard Member States' sovereignty by placing limitations on EU competences to prevent violating their sovereignty. States can therefore take bigger risks with multilateral cooperation and the idea of accepting limitations on sovereignty is not nearly as radical as it would be at the UN or the OECD. The experience of the FTT might make one think that there is no appetite for tax cooperation at the EU level. That is simply untrue. If anything, there is an increasing willingness for a coordinated approach to be taken across Member States, evidenced by the relative support for the Commission's Anti-Tax Avoidance Directive.[156] The FTT was simply a bad test case for tax multilateralism and offers a lesson in how not to approach international tax cooperation. Instead, tax multilateralism in the financial services sector should be approached gradually starting with a better-designed tax

[153] ibid 182.

[154] Thomas Friedman, *The Lexus and the Olive Tree: Understanding Globalization*. (Farrar, Straus & Giroux 1999).

[155] Rodrik (n 152) 185.

[156] Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L193/1.

with a narrow, yet well-defined scope (like the SDRT) and the EU remains the ideal forum to do this.

E. CONCLUSION

As the discussion above lays bare, the failure of the FTT was the result of the design of the tax, which meant that the FTT was unfit for purpose. However, it would be naive to remove the design issues from the context of the ECP. So, while 'the controversial nature of the tax' had a 'significant influence on the journey of the FTT proposal through the ECP', we must not forget that the most controversial aspects of the tax were products of the ECP itself.[157] The differentiated integration process initiated by the ECP made the introduction of the issuance principle and the GAAR all the more necessary to safeguard participating Member States from the negative effects of their desire to cooperate. Unsurprisingly, these are the parts of the FTT proposals that have been subject to the most scrutiny.

Critics of FTTs, in general, tend to raise the same concerns to conclude that FTTs are unworkable and unproductive taxes.[158] The truth is that FTTs, with the right design, can be very workable and provide a source of revenue for indebted governments. The comparative experiences of the UK and Sweden highlight that the key is in careful design. The fundamental mistake of the Commission was trying to cover *all* bases through its triple-A approach, the multitude of connecting factors and over-generalised GAAR. In trying to solve all the known weaknesses of FTTs, the Commission created more problems than it solved. The result was a mismatched and poorly designed tax that was too remote from its taxable object and therefore unjustifiable. Thus, the design of this specific FTT made it unworkable and unproductive. If a better-designed tax were brought to the table, backed by multilateral consensus across all Member States, it might be palatable for politicians and please constituents alike.

Lastly, the FTT was simply a bad test case for tax multilateralism. The reality of the global economy is that tax sovereignty has been severely eroded, and states are essentially fiscally interdependent. If states adopted a coordinated approach to taxes like the FTT, they would reap the benefits while ensuring minimal avoidance and risk. Regardless of the eventual failure of the FTT, the EU is still the best forum to experiment with supranational tax law because of how the Treaties effectively balance Member States' sovereignty with the EU's legislative competence.

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[157] Cédelle and Vella (n 36) 358.

[158] See Henry, Hillman, and Shaxson (n 6).