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Trade Strategy

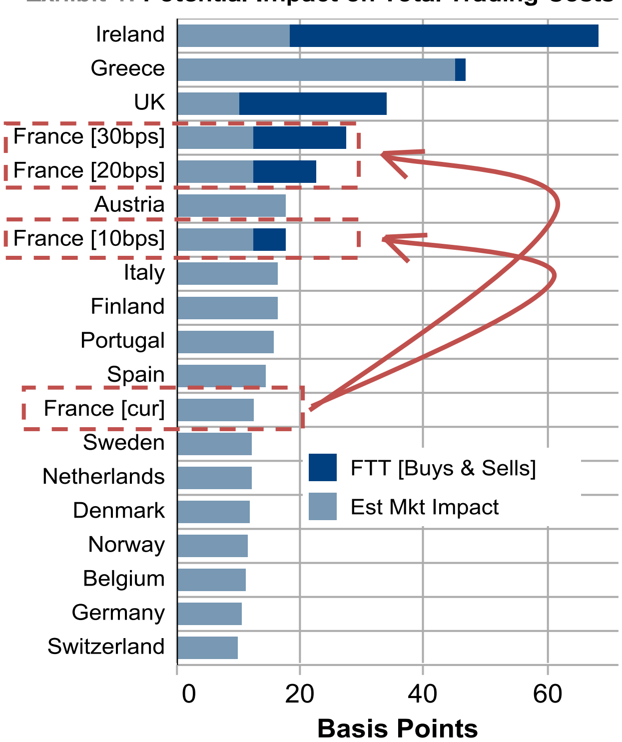
Transaction Taxes in Europe – What's the latest?

Market Commentary 26 June 2012

Key Points

- In August 2012 France's financial transaction tax (FFTT) will go live.
- A proposal from the Hollande government to increase the "tax on shares" element of the FFTT from 10bps to 20bps or 30bps is thought to be imminent. There is also uncertainty as to whether depository receipts are already in scope or will be added to the scope of the FFTT.
- On 22 June, EU Finance Ministers rejected the EC's proposal for an EU wide broad-based FTT. However, a subset of countries are pushing for an FTT under "Enhanced Cooperation", involving a minimum of 9 member states.
- In the meantime, it is possible that individual countries could follow France's lead by introducing national taxes.

Exhibit 1: **Potential Impact on Total Trading Costs***



Source: Credit Suisse Trading Strategy June 21st, 2012

*Market impact estimates are based on the Credit Suisse EDGE pre-trade model and assume a trade size of 1% ADV in each market, executed at 25% participation. The FTT charge (i.e. "FTT [Buys & Sells]") represents the average buy-sell cost in each market – e.g. stamp duty in the UK is 50bps on buy trades only, so the average buy-sell FTT cost (as shown in the chart) is 25bps.

French FTT to Go Live in August

On 1 August 2012, France's financial transaction tax (FFTT) covering equity transactions, HFT and naked exposure to EU sovereign debt through CDS will come into effect. As highlighted in **Europe's Dalliance with FTTs**, it could lead to increased costs for end investors and greater use of derivatives. However, HFTs will be relatively unscathed as the tax on HFTs only applies to those operating in France and the "tax on shares" only applies to *net* buys.

What Could Change Between Now & Then?

Tax on Shares Could be Increased to 20bps or 30bps

Following the Socialist Party's recent majority win in the Assemblee Nationale elections, the Hollande government is expected to imminently propose an increase in the "tax on shares" rate from 10bps to as high as 20bps or 30bps. The move – which could be tabled at the French Council of Ministers meeting on 27 June, or more probably 6 July – would make France the 4th most expensive market to trade in Europe (see Exhibit 1). The bill is highly likely to be approved in July given the Socialist party's controlling majority in the upper and lower houses of the French Parliament.

ADRs Could be Added to the Scope

There is uncertainty as to whether depository receipts are already in scope or will be brought into the scope of the FFTT. The French tax authorities may decide that the FFTT is also applicable to trades in depository receipts. Alternatively, they could follow the UK's approach whereby an upfront charge of 1.5% is applied on conversion of ordinary shares into depository receipts (e.g. ADRs). Thereafter, trades in depository receipts can take place without the FTT charge being applied since the registered owner of the underlying share is unchanged.

Technical Difficulties Abound

Buy-side & Sell-side Will Need to Update Systems

Adding 10, 20 or 30 basis points to the cost of a trade sounds easy; however, in practice there are a host of technical challenges to being ready for 1 August. These include back-office system changes by both the buy-side and sell-side and the reconciliation of different accounts and account types (e.g. to facilitate the determination of *net* buys).

The definitive list of securities which will be covered by the FFTT is not yet known and the method of tax collection has not yet been defined. A number of investment banks have proposed that the tax be calculated at the end of the trade date, with the actual collection being part of the settlement process; initial discussions with buy-side firms indicates general support for this proposal.

The EU FTT is Dead, Long Live the EU FTT

"Enhanced Cooperation" Proposed after Rejection of Broad-Based EU wide FTT

On 22 June, EU Finance Ministers rejected the EC's proposal for an EU wide broad-based FTT, acknowledging that it would be impossible to gain the unanimous support required of all 27 member states.

However, a subset of countries (led by Germany and Austria)[1] have announced that they will push for an FTT under "Enhanced Cooperation", a process whereby a minimum of 9 member states can move ahead as a bloc without the other members of the EU. Details are limited at this stage, but it is rumoured that the proposal could be based on a form of stamp duty levied at 0.25%[2] and involve Austria, Germany, France, Spain, Italy, Belgium, Slovenia, Portugal, Greece and Bulgaria (subject to the substance of the new proposal). To get the go-ahead, a qualified majority of member states would be required to support the proposal.

Meantime, Other Countries Could Follow France's Lead

The potential for delays in implementing an "Enhanced Cooperation" FTT could be a key driver in the possible emergence of national taxes (following France's lead) in the meantime, particularly in pre-election environments. Hungary has already announced plans to introduce an FTT in 2013. In our view, other countries are likely to follow.

[1] https://mninews.deutsche-boerse.com/index.php/door-opened-some-eu-govts-plan-common-fin-trans-tax?q=content/door-opened-some-eu-govts-plan-common-fin-trans-tax
[2] http://www.telegraph.co.uk/finance/debt-crisis-live/9348354/Debt-crisis-as-it-happened-June-22-2012.html

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