How can we implement today

a Multilateral and Multi-jurisdictional Tax on Financial Transactions?

Les financements innovants pour le développement

Groupe Pilote

International Expert Report

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PREFACE TO THE BLUEPRINT

1. Origins of the Treaty

The Blueprint for an International Treaty on a Multilateral and Multi-jurisdictional Tax on Financial Transactions has two basic aims:

1. To introduce an innovative financing mechanism for global development. The mechanism is an internationally coordinated tax in the financial sector for a common or coordinated Development policy.

2. To contribute to global financial stability, to increase policy autonomy of States and to enhance the proper functioning of real economy by discouraging financial speculation.

This blueprint is part of a process, highlighted in the *Report of the Committee of Experts to the Taskforce on International Financial Transactions and Development of the Leading Group on Innovative financing to fund development: Globalizing Solidarity: The Case for Financial Levies (2010)*[1] towards the realization of international mechanisms to address the vast shortfall in finance required to meet international global developmental and environmental challenges and commitments.

This blueprint therefore aims to facilitate the political decision-making process by addressing in a consultative document for discussion the technical-legal feasibility issues of an international system of tax collection.

2. Recommendations

The G-20 is a most appropriate platform to initiate the process of implementation, for two reasons:

- in order to avoid economic distortions in globally integrated financial markets and not to unduly restrict free movement of capital,
- the erosion of the tax sovereignty of States acting with inefficient solitary tax mechanisms without combined efforts in a world of global capital markets

We therefore draw the following conclusions:

- The blueprint includes the central recommendation of the Expert Committee for a centrally collected multi-jurisdictional transaction tax. It explains the basic features of a broad based financial transaction tax. It introduces a solid international system of tax collection at the level of (central) financial market infrastructure including, for currency transactions the point of global settlement. The draft treaty does not list specific institutions but provides for functional criteria that permit unbiased objective mandates
- This international system is based on national tax sovereignty and is supervised by a political body of all Contracting States (the FTT-Council). Contracting States will govern, through the FTT-Council, upon advice of Developing States and Civil Society, part of the commonly generated

1- www.leadinggroup.org

revenue. The functioning however of this body requires further political decisions on choice for which inspiration on operational principles can be sought in the Expert-report of 2010 (Sec 4.2.3)

- The proposed Treaty suggests a harmonised tax approach towards the markets without borders : the build up should preferably following up on a G20 declaration (call) and be adopted by a large number of countries, either (i) as an EU initiative (possibly through a limited group[2] of Member States that engage in an enhanced cooperation[3]) supplemented with EU agreements with other States[4], or (ii) as a multilateral treaty among a number of States, to which some EU members would participate or (iii) as a multilateral treaty, to which economic regions such as the EU could adhere as a whole.

- The innovative mechanism can be gradually put in place and be reviewed after a period of transition.

- The political arbitrage, possibly with a phase-in approach, is required typically to agree on the scope of the FTT. Therefore the blueprint mentions several options on financial markets and assets, and on the tax-rates to be applied and refers to economic policy advisors that can facilitate with their recommendations the political decision-making.

- The catch-all approach of the draft guarantees market neutrality for the mechanism to be in conformity with the provisions for free movement of capital and payments for goods and services including financial services embodied in the instruments of international and regional law (Gats, EU, etc). Selectivity reducing the scope may thus risk the mechanism to be at odd with those principles of international economic law.

- The Treaty sets up a mutual legal mandate and cooperation between financial authorities so that a mandate can be given to the central settlement and payment institutions and other financial intermediaries to collect the taxes according to the commonly agreed design. This cooperation would rely on existing instruments for international tax-collection, where necessary expanded to the broad FTT.

- For instance, for the highly centralized global currency-market, "participating States that would call upon central settlement institutions such as the CLS bank, could impose a third party collection system through the mutual mandate to those States that have the territorial jurisdiction over the settlement institutions."

- The FTT, being set up in several countries, may lead to double taxation. A proposed electronic-FTT-tag device may be a core instrument to avoid this risk of multiple taxation.

3. Resolving the global solidarity dilemma

→ This multilateral and multi-jurisdictional mechanism, making real the main conclusion of the expert report, shall help "resolve the global solidarity dilemma. Although the financial sector, which benefits disproportionately from the globalisation of economic activity, would pay a significant contribution, the burden of payment would also ripple out from settlement institutions across global financial and economic activity. Revenue would not be raised in an asymmetrical manner by the nations with global financial centers, but would be spread across global activity to pay for global public goods. Global collection mechanisms also avoid the domestic revenue problem, enhancing stability[5]."

For those in charge now : Noblesse Oblige !

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20 September 2011

2- A Eurozone approach would be recommendable when FTT is to apply on currency exchanges involving the euro.

3- Requiring the participation of minimum 9 EU Member States. The EU enhanced cooperation system is governed by Articles 20 and following of the Treaty on European Union (consolidated version O.J. 30 March 2010, C83/13).

4- E.g. the EU Savings Tax Directive and associated agreements with Switzerland, the understanding with the USA and the many agreements concluded with States that host off shore financial centres.

5- *Report of the Committee of Experts to the Taskforce on International Financial Transactions and Development of the Leading Group on Innovative financing to fund development: Globalizing Solidarity: The Case for Financial Levies (2010).*

1. BACKGROUND AND THE WAY FORWARD

The proposed Treaty materialises Contracting States' ambition to create a new source of revenue for development funding purposes by levying a tax on financial transactions. As set out in the Preamble, the choice to tax financial transactions is made in view of the substantial benefits that the financial markets have gained from the process of globalisation (guaranteed by the regulatory and stabilizing efforts of the Contracting States to safeguard financial markets) while, at the same time, financial globalisation is having significant adverse effects on developing countries' economies. It is also expected that taxing financial transactions will temper speculative activities that have caused much instabilities in international finance in the recent time.

The idea of taxing financial transactions is not new. In the past, Keynes (1936[6]) and Tobin (1978[7]) proposed a tax on securities transactions and a tax on currency trades (respectively) with a view to reduce speculation and market volatility. A financial transaction tax – for development purposes or else – is now attracting a renewed interest at the level of political leaders, as could be observed during the recent G-20 summits.

Earlier this year, the European Parliament called for the introduction of a low-rate financial transactions tax which, according to the MEP's, could raise around €200 billion per year in the European Union and would also discourage speculative trading by making it more costly. If imposing this tax worldwide proves too difficult, then the European Parliament takes the view that the EU should impose it at European level[8]. In the aftermath, the European Commission presented a proposal for a reform of the European own resource system, including the introduction of a financial transaction tax that could reduce the existing Member State's contributions, give national governments extra room for maneuver and contribute to the general budgetary consolidation efforts. According to the Commission, this new tax could constitute a first step towards the application of a financial transaction tax at a global level[9]. Last August, President Sarkozy and Chancellor Merkel also defended the introduction of a tax on financial transactions in the broader framework of stabilization measures for the Eurozone.

Building on recent Tax&Regulatory Policy developments

Levying a tax on financial transaction raises several key policy issues that have already been widely discussed (recent analyses include apart from the pioneering research by Schulmeister[10], the Expert Report to the Task Force on International Financial Transactions of the

6- Keynes, J. M., The General Theory of Employment, Interest and Money, MacMillan, London, 1936.

7- Tobin, J., "Proposal for International Monetary Reform", Eastern Economic Journal, 1978, 4, pp. 153-159.

8- See "MEPs call for the introduction of a tax on financial transactions", European Parliament Press release following their plenary session of 8 March 2011 (http://www.europarl.europa.eu/en/pressroom/content/20110308IPR15028/html/MEPs-call-for-the-introduction-of-a-tax-on-financial-transactions).

9- European Commission "Proposal for a Council Decision on the system of own resources of the European Union", 29 June 2011, COM(2011) 510 final 2011/0183 .

10- S. Schulmeister, "A General Financial Transaction Tax: A Short Cut of the Pros, the Cons and a Proposal", Österreichisches-InstitutfürWirtschaftsforschung Working Paper 344/2009 (hereafter "Schulmeister").

Leading Group for the Finance of Development[11], the IMF Working papers by Matheson[12] and Brondolo[13], and exploratory work by the European Commission[14]). The proposed Treaty considered these contributions addressing both the conceptual and practical difficulties of taxing the financial markets (defining the taxable persons, taxable base, organising collection), and the challenges related to tax evasion and avoidance in an environment where the ingenuity of the financial industry may complicate enforcement (cross-border collection and audits, mutual assistance). Inspiration has been sought in Patomäki & Denys' Consultative Document "Draft Treaty on Global Currency transaction Tax" of 2002-2005 whose principles have been integrated in the present draft.

Recent developments on which the Treaty strongly rely include the rapidly developing financial markets regulatory framework[15], providing for an expanding role of clearinghouses in settling financial transactions, the proliferation of automated trading platforms, the large degree of automation of financial markets activities in general, and the strengthening in the regulation of complex financial products such as derivatives.

Building on experiences intax coordination on a multilateral and multi-jurisdictional basis

→ The proposed Treaty takes advantage of the vast experience gained with several international instruments such as : the Uniform EU Customs Code applicable in 27 States of the EU Customs Union, the almost universally introduced Value Added Tax which is transaction based and internationally harmonised in its basic design and tax concepts, the extra-territorial harmonised savings tax scheme[16] implemented in the 27 Member States of the EU and coordinated with its major financial partner-States (i.e. Switzerland and the United States, as well as with its associated offshore centres around the EU, and the authoritative US experience of levying withholding taxes abroad through foreign Qualified Intermediaries.

The proposed Treaty also takes advantage of the G20 induced wave of tax cooperation and transparency conventions that emerged since the 2008 global financial crisis, in particular the impressive outcome of the OECD Global Forum on transparency and exchange of information for tax purposes.

The way forward for implementation: Tax Challenges in financial markets require a combined cross border international approach

→ In order to avoid economic distortions in globally integrated financial markets and not to unduly restrict free movement of capital, but faced with the erosion of the tax sovereignty of States acting with inefficient solitary tax mechanisms without combined efforts in a world of global capital markets the proposed Treaty could

11- Report of the Committee of Experts to the Taskforce on International Financial Transactions of the Leading Group on Innovative Mechanisms for the Finance of Development, "Globalizing Solidarity: The Case for Financial Levies", June 2010 (hereafter "Leading Group Report"); the section on the FTT is enclosed in annex .

12- T. Matheson, "Taxing Financial Transactions: Issues and Evidences", IMF Working Paper WP/11/54, 2011 (hereafter "Matheson").

13- J. D. Brondolo, "Taxing Financial Transactions: An Assessment of Administrative Feasibility", IMF Working Paper, WP/11/185, 2011(Hereafter "Brondolo").

14- European Commission, "Proposal for a Council Decision on the system of own resources of the European Union", 29 June 2011 COM(2011) 510 final. See also European Commission Staff Working Paper "Financing the EU budget: Report on the operation of the own resource system", Accompanying the "Proposal for a Council Decision on the system of own resources of the European Union", 29 June 2011 SEC(2011) 876 final.

15- In particular the EU MIFID (Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC O.J. L 145 of 30 April 2004); the European Commission Proposal for a Regulation of the European Parliament and OTC derivatives, central counterparties and trade repositories", 15 September 2010, COM(2010) 484 final (See also the European Commission Working Document "Public Consultation on Derivatives and Market Infrastructures", http://ec.europa.eu/internal_market/consultations/docs/2010/derivatives/100614_derivatives.pdf), Oxera Report (prepared for DG Internal Market and Services")"Monitoring prices, costs and volumes of trading and post-trading services", May 2011, (MARKT/2007/02/G), and "The Code of Conduct on Clearing and Settlement: three years of experience",European Commission, Internal market and services DG,6 November 2009.

16- Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, O.J. 26 June 2003, L 157/38 (hereafter "EU Savings Tax Directive"). In the meantime, after this blueprint was submitted, an in depth impact assessment and a draft for an EU-directive have been published.

develop gradually a harmonised tax approach towards the markets without borders : the build up should preferably following up on a G20 declaration (call) and be adopted by a large number of countries, either (i) as an EU initiative (possibly through a limited group[17] of Member States that engage in an enhanced cooperation[18]) supplemented with EU agreements with other States[19], or (ii) as a multilateral treaty among a number of States, to which some EU members would participate or (iii) as a multilateral treaty, to which economic regions such as the EU could adhere as a whole.

The proposed tax is, however, designed to safeguard and maintain an economic level playing field, and to avoid competitive disadvantages for the Contracting States thanks to a very broad jurisdictional reach reinforced by international cooperation in the collection of the tax, still in compliance with the traditional principles of tax sovereignty and tax territoriality. Also with the purpose of avoiding economic distortions, the proposed multilateral tax has a broad scope of application, which embraces all financial transactions and financial assets, all markets and market participants, thereby not only preventing tax driven delocalization and asset-substitutions, but also avoiding risks of double and multiple taxation.

The proposed Treaty is open to all States to join on equitable terms. Participation will not prevent them from combining the tax with other financial levies aimed at serving different purposes, provided these do not jeopardize its application.

Finally, the Blueprint is meant to facilitate discussions and negotiations and is thus presented as a working document for consultation. It therefore includes a number of options (indicated as [ ]) to be considered for discussion, for example the question whether the Treaty should be open for revision with respect to its basic features only after a reasonable time of e.g. three years after implementation, or should rather be adopted on a temporary basis.

17- A Eurozone approach would be recommendable when M-FTT is to apply on currency exchanges involving the euro.
18- Requiring the participation of minimum 9 EU Member States. The EU enhanced cooperation system is governed by Articles 20 and following of the Treaty on European Union (consolidated version O.J. 30 March 2010, C83/13).
19- Cfr. the EU Savings Tax Directive and associated agreements with Switzerland, the understanding with the USA and the many agreements concluded with States that host off shore financial centers.

2.
OUTLINE OF THE M-FTT TREATY: SUMMARY MEMORANDUM

A. Basic features

A tax on financial markets

➔ The proposed multilateral financial transaction tax ("**M-FTT**") targets all sectors of the financial markets and not domestic financial centres as such.

To support global development

➔ The M-FTT aims at generating substantial revenue to the benefit of global development. Contracting States could automatically transfer a percentage of the M-FTT revenue to a [Multilateral, Common] **M-FTT Development Fund**. The remaining percentage shall be kept by the Taxing State or, as the case may be, shared with a Collecting State.

A national, broad-based and low-rated tax

➔ The M-FTT is designed as a national tax with a possibly exceptionally wide- still comprehensively defined- base. Nearly all financial products, all market players and the entire financial infrastructure connected to the territories of the Contracting States (the M-FTT Zone) fall within the scope. As a result, distortive effects on financial flows (e.g.substitution of financial products or delocalisation) can largely be foregone. In that context, low rates of taxation also ensure that the volumes and functioning of the financial markets are left practically intact, while still generating a substantial level of revenue.

A multi-jurisdictional & multilateral, centrally collected, stamp/ withholding tax

➔ The M-FTT is introduced as a tax on financial markets without territorial borders simultaneously in several jurisdictions that coordinate their tax collection for a common, multilateral purpose. Its collection is market-based and mostly centralised. An important practical feature is that the M-FTT could be implemented, in virtually all cases, on the basis of experienced procedures. In practice, and depending on the type of transactions, it will function as *withholding tax* imposed by national tax authorities but collected by and at the level of (third party) financial intermediaries (i.e. payment and settlement-infrastructure, banks and financial and trading intermediaries).

In the exceptional situations where no financial market infrastructure or intermediary can be relied upon, and thus no withholding tax could be levied (i.e. where no third party intermediary at all is subject to the extended extraterritorial reach of the taxing States, see infra) the M-FTT will function as a *stamp tax*. In that case, collection will take place on a *self-assessment* and *reverse charge* basis (i.e. by the parties to the financial transaction themselves, supported by the existing international tax collection instruments and the regulatory monitoring, and induced a.o. by the risks of multiple taxation and the legal non-enforceability of the transactions in case of non-compliance).

Multi-phased implementation, global opening

Although the M-FTT should eventually be levied at a global level encompassing all important financial markets in order to maximise both revenue flows and neutrality, there is no immediate need for a universal consensus. In a first phase, the system shall be built on the presence of financial market infrastructure, banking sector, market participants or financial products, where there is at least one connecting link to the M-FTT Zone and on experienced national taxes on securities, modelled according to the substantive provisions of this treaty and enhanced by international coordination.

Governance/Implementation of the Treaty and monitoring

An M-FTT Expert Committee from multiple jurisdictions will assist the national authorities to enact appropriate domestic rules and procedures, including as regards bookkeeping, and to interpret the Treaty in a harmonised fashion with a view to ensure a comprehensive collection of the tax. However, the objective of the Treaty is to allow, a much as possible, for collection through existing regulated intermediaries, and to apply (and expand where needed) the existing framework of international cooperation (with extraterritorial reach) for the collection of tax claims. Contracting States are also expected to cooperate with international financial supervisory authorities.

Finally, the implementation of the Treaty will be supervised by a Council (decision making body consisting of the representatives of the Contracting States), a Permanent Secretariat, and the consultative committees, e.g. of Development Countries and Civil Society representatives for executive policy of the Development Fund and the M-FTT Committee of experts (in charge of technical advise, and composed of independent experts appointed on the basis of nominations by Contracting States, [Developing Countries], the stakeholders of the financial markets and Civil Society).

B. Outline of the design of the M-FTT

Taxable transactions and instruments

The M-FTT applies to any trade infinancial instruments on the secondary capital market. The financial instruments whose transfer will be taxed include shares, bonds, [money market instruments], [currency] and the derivatives thereof [as well as derivatives of commodities, gold, emission trading etc]. The M-FTT covers all kind of financial markets, transactions and products, and all market players. Such a broad tax base guarantees the economic and legal neutrality of the tax, as well as its revenue potential.

Tax Rates

M-FTT rate is fixed as a percentage of the taxable amount. A differentiated set of rates applies, depending on the nature of the underlying asset to the transaction. The draft suggests a general rate of 0,05 and one or two increased rates:either 0,2% for equity,or 0,1% for long term debt instruments and 0,5% for equity. An option not generally supported, could be to exempt in a transitional phase short term cash-like transactions (including spot currency market).

A technically "double transaction" with an intermediary acting in his own name such as at some regulated exchangeswill be taxed twice because the intermediary will technically acquire and sell the assets. Accordingly, a rate adjustment is proposed.

Taxable Amount

The taxable amount under the M-FTT consists of the consideration (payment) by the transferee (buyer) received by the party transferring the taxable financial instrument (seller). The M-FTT will be levied on a transaction per transaction basis (i.e. before netting).

Taxable event

In rule, the M-FTT is due when the trade is settled (i.e. delivery of the financial instrument versus payment).

Taxable persons and tax collection

Ultimately the taxpayers are the parties to the transaction, including dealers/traders and central counterparties acting in their own name. They will in principle bear an equal share of the tax burden. They may mutually agree otherwise without however affecting the rights of the State having taxing rights over the transaction (the **Taxing State**) – e.g. typically an Exchange will generally "withhold" the tax from the payments to and from investors and other market players. This may generally be the case for central counterparties.

Tax collection liability will, in most cases, lie on **third parties**: the providers of financial infrastructure or intermediaries. They will collect the M-FTT whenever they intervene in the clearing, payment or settlement of a taxable transaction or, if no such post-trading phase is envisaged, in the trading itself.

Where there is no third party tax collection the taxable parties will be fully liable, including, on a reverse charge basis, for the tax to be borne by the other non residenttaxable person(s).

When the third parties collecting the FTT are resident in another State of the M-FTT zone, their State of residence (the **Collecting State**), will monitor and enforce the collection **on behalf of the Taxing State**.

Upon the taxable event, the third party financial intermediary will thus collect and remit the tax to the tax authorities in accordance with the applicable allocation of taxing rights rules. Where appropriate, **Taxing and Collecting States will share the "collection" fee** part of the revenue and could transmit the X% part for development purposes to **the M-FTT Development Fund**.

If the third party collection is performed from outside the M-FTT zone mutual assistance for tax collection may be requested under the existing international instruments – that have a vast network of assistance in collecting taxes – to verify compliance and when needed enforce the tax claims.

Because financial intermediaries, also from abroad, may be required (under regulatory pressure) to submit returns and remit the M-FTT to several tax authorities, **a one-stop-scheme** is set up, under which compliance obligations may be centralized in one single country of their choice ("**Collecting State of choice**") that will redistribute the tax revenues according to the treaty rules. Depending on the person liable for the collection of the tax, the reliance to the one-stop-scheme will either be optional or compulsory.

Liberalising electronic "FTT-tag"

A crucial feature of the M-FTT collection is that a *liberalising* electronic "tag" will be attached to any financial transaction on which the M-FTT has been paid, relieving the other intermediaries in the transaction chain, and thereby ensuring legal certainty and avoiding double and non-taxation. A non-tagged transaction entails the risk of multiple taxations, thus encourages tax compliance. This feature requires the adoption of a high fraud-proof electronic device approved by the Contracting States.

Territorial reach of the tax, allocation of taxing rights and coordination of cross border tax collection

For efficiency and neutrality reasons, the M-FTT is designed to apply on the largest possible scale, still in compliance with the traditional principles of sovereignty and territoriality, as extended by international instruments for cooperation in tax matters. With that purpose, the Treaty provides for **abroad range of territorial connecting factors** triggering the application of the tax, i.e. allowing for the adoption of legislative norms to impose the tax and to supervise / enforce its collection, across the borders where necessary, with the assistance of other States (including Contracting and Non-Contracting States) who committed to cooperate either on the basis of the Treaty or on the basis of any other international instruments providing for cooperation in tax matters. A vast multilateral network of cross border tax collection has been built up: since 2010 it covers the entire EU and other multilateral and bilateral conventions expand this extraterritorial tax collection.

In practice, the M-FTT will apply on any taxable transactions whenever at least **one of the parties to the transaction** is established or resides in one of the Contracting States, or when at least **one of the intermediaries** is established in one of the Contracting State, or on the basis of the

nationality/territoriality of the financial instrument e.g. when the institution issuing the taxable instrument (e.g. sovereign bonds, corporate shares and bonds) is established in one of the Contracting State.

Backing up the (self-interest driven) self-acting third party tax collection of the financial intermediaries and their market infrastructure, a comprehensive set of multilateral rules governing the allocation of taxing rights and competences between the Contracting States (hence defining the "**Taxing State**" and "**Collecting State**") organises the application of these respective connecting factors, with a view to avoid evasion, double (multiple) or unintentional non-taxation, and to ensure a correct and coherent application of the M-FTT between the Contracting States. To that effect, mutual authorisations to mandate cross border (third party) tax collection are foreseen.

Tax evasion

The Treaty takes the view that the more appropriate way to minimize tax avoidance and evasion is to render fraud a low return, high-risk activity. The first aspect (low return) is achieved thanks to the low tax rate structure of the M-FTT minimizing the incentive to avoid the payment of the tax. The second part (high risk) implies to provide for severe consequences in case on non-compliance. In that respect, the Treaty provides for the **unenforceability of financial transactions** on which tax has not been paid. Those are easily recognizable by the absence of the electronic tag mentioned above. In practice, a non-taxed, and therefore non-tagged, financial transaction, cannot be enforced. This means that the financial transactions will not give right to delivery nor payment, nor will the instrument entitle to dividends, interests or voting rights, nor will it be tradable. This also ensures compliance for instruments traditionally considered as hard-to-tax such as derivatives and OTC transactions, as a non-legally enforceabletransaction will not be considered eligible for central clearing (nor settlement), which is becoming a regulatory requirement for all exchange traded instruments.

In addition to non-enforceability, extraterritorial collection on the basis of existing international instruments, as well as a consolidated single taxpayer approach (defeating tax evasion through the reliance on offshore entities), the external auditing role with global financial groups, and cooperation with financial market authorities will prevent financial institutions from circumventing the M-FTT. No-compliance and fraud will be subject to severe sanctions.

Finally, and more generally, the Treaty also provides that Contracting States should agree to share tax information regarding the financial markets and to apply their existing supervisory mechanisms for M-FTT purposes (including money laundering prevention instruments).

3. DRAFT TREATY ON A TAX ON FINANCIAL TRANSACTIONS

Preamble

The high contracting parties ...

Recalling the far-reaching adverse effects of distortion in Global Development increased by financial instability and speculation,

Desiring to mobilise resources generated by capital flows on the financial markets that benefit from global financial stability guaranteed by the Contracting States,

Desiring to create revenues that can be used for developmental purposes,

Determined therefore to implement a Multi-jurisdictional Financial Transactions tax,

Have decided to establish a Multi-jurisdictional Transaction Tax and to introduce an international Council of States to organise a common development policy and advisory committees to assist the Contracting States in the implementation,

Have decided to conclude this Convention, and to this end have designated a their Plenipotentiaries:

Who, having exchanged their Full Powers, found in good and due form,

Have agreed as follows

Part I
General provisions

Introduction of the M-FTT system

Article 1

By this Treaty, the Contracting Parties agree to introduce a common and coordinated, multilateral and multi-jurisdictional system of taxation on financial transactions hereinafter called "Tax on Financial Transactions" (M- FTT or FTT).

Purpose of the Treaty

Article 2

This Treaty and the M-FTT shall aim at the following objectives:

1. To generate revenues to be utilised for the global common good and in particular for Global Development [in the participating Developing Countries listed in Annex].

2. To organise international cooperation and coordination for the application of a Multi-jurisdictional and Multilateral Financial Transaction Tax.

Implementation

Article 3

§1 Contracting States shall introduce a common and coordinated Financial Transaction Tax according to principles as determined in art. 4 to 16 of this Treaty.

Contracting States shall adopt the necessary laws, regulations and administrative provisions so that the Financial Transaction Tax system enters into force at the earliest opportunity and in accordance with article 26.

§2 Any term not defined in the treaty shall, unless the context otherwise requires, have the meaning that it has under the law of the State that applies the treaty, the meaning under the applicable tax and financial law prevailing over the meaning under other law.

Allocation of M-FTT revenue

Article 4

§1 Contracting States shall, on a regular basis, use a percentage [X% or as will be agreed] of revenue from the FTT to finance [international] Development orto fund the Common FTT- Development Fund established under article 17 [as will be agreed].

§2 Contracting States shall retain the remaining [Y%] of the revenue [if the place of the financial transaction determined according to art 12 is within their jurisdiction or, subject to art 14, transfer two thirds of that amount to the other Contracting State if the place is within the jurisdiction of that other Contracting State on whose behalf the FTT has been collected in the Contracting State].

Part II
Design of the common M-FTT tax system

Scope and territorial application

Article 5

Shall be subject to FTT any financial transaction within the territory of the Contracting States by a taxable person, hereafter "**a taxable transaction**".

Article 6

For the purposes of this Convention the territory shall be the territory of the Contracting State as stipulated in annex.

Taxable persons

Article 7

§1 "**Taxable person**" shall mean any person [not being an employee acting as such] who carries out, even on an occasional basis, a taxable transaction within the territory of a Contracting State.

Taxable person shall also include ultimate beneficiaries on whose benefit as beneficial owner or on whose behalf, directly or indirectly, a transaction is carried on.

Intermediaries acting in their own name

§2 Taxable person shall also include persons acting in their own name on behalf of another person.

Group of associated entities

§3 For the purpose of simplification, prevention of evasion, avoidance or abuse, a Contracting State shall [may] for the application of art 8, 12, 13, and 15 treat as a one Person, hereafter a "**Single Entity**", taxable persons [or persons liable to pay the FTT as FTT Collection Agents according to art 13], whether or not established in the same country, who, while legally independent, are part of a group of persons closely bound to a taxable person resident in one of the Contracting States by financial, economic and organisational links amounting to control of that person over the other group entities .

Taxable transactions

Article 8
"Taxable Financial Transaction"

§1 A taxable "**Financial Transaction**" shall mean the transfer of a financial instrument, including a financial derivative contract, for consideration, whether immediate or on deferred terms.

§2 The **transfer** of a financial instrument shall mean the transfer of the right to dispose of the financial instrument as owner.

§3 The **transfer** of a financial instrument shall also mean the entering or conclusion, the exercise or execution a financial **derivative contract,** and the transfer, assignment or novation of a financial derivative contract.

§4 For the purpose of the application of art 12, art 13 and 15 a transaction in which a financial instrument is exchanged for another financial instrument shall constitute two separate taxable transactions.

§5 Where multiple transactions, or parts thereof, are combined or converted into one net claim or net obligation before payment and final settlement [on the basis of net positions between taxable persons], each transaction shall be taxed as a separate taxable transaction.

Where transactions are paid or settled after establishing a net claim or net obligation, the taxable persons, or the person clearing or establishing the net positions shall, under risk of liability to pay the FTT, inform [short-circuit] the person liable to pay the FTT tax, as the case may be as a third party provider of the final payment services or final settlement services, of the gross transactions for the purpose of the calculation of the FTT.

§6 Where a person acting **in his own name** and on behalf of another person [or by interposing between taxable persons] carries out a financial transaction or intermediates, he shall be considered to transfer or receive the financial instrument or the consideration.

[All transactions of a **Single Entity,** whether within the group or with other taxable persons, shall be deemed to be carried on by the taxable person, resident within a Contracting State that has control over the group entities.]

§7 Shall not be considered a taxable financial transaction, **the issuance** of shares or debt instruments, the granting of credit and the reimbursement of paid-in capital other than transactions with units in investment undertakings. A transfer of financial instruments in consideration of such non taxable transaction shall be a taxable transaction.

§8 Inthe event of a transfer, whether for consideration or not as a **contribution** to a company resident in one of the Contracting States, of a financial instrument, part of a **totality of assets** in the framework of a restructuring of entities through a merger, including an exchange of shares resulting in a controlling participation, a demerger or an incorporation of a branch or establishment, Contracting States shall consider that no taxable transfer of financial instruments has taken place and that the person to whom the instruments are transferred is to be treated as the successor and substitute to the transferor.

A contracting State may refuse the application of this paragraph where it appears that the restructuring has as one of its main objectives to avoid the application of the M-FTT.

§9.1 For the purpose of preventing evasion, avoidance or abuse, a taxable financial transaction shall also be taken to mean a **transaction** that has **equivalent effect** as a transfer of a financial instrument for consideration ; such transaction shall also mean an exchange of instruments that imply risks proper to the fluctuation in value of financial instruments or market elements and an exchange of goods, substituting for transfer of financial instruments.

§9.2 For the purpose of preventing evasion, avoidance or abuse, a taxable financial transaction shall also be taken to mean a transfer of a financial instrument not for consideration to an entity or establishment which is not a taxable person.

§10 Financial instruments

A " financial instrument" shall mean an element negotiable on a financial market including a security, whether materialised or not, as specified hereafter .

[*Optional*
A "financial instrument" shall also mean a financial **derivative contract** relating to an underlying financial instrument or [financial] market element that fluctuates in value, that establishes [or transfers] a right or obligation to purchase or to sell or to transfer or to deliver a financial instrument or an exchange of payments based on a financial instrument, a rate, an index, an event, element or measure relating to the financial market or a risk associated with a financial instrument or the fluctuation in value of any of the preceding.]

§10.1 Financial instruments shall [however only] include:

A.) **Shares** and interests in companies or associations, including securities equivalent to shares in companies, partnerships or other entities, units in investment undertakings and depository receipts in respect of shares;

B.) Bonds or other forms of **debt instruments** [*Optional*: and **money-market instruments**] whether

(B.1) Instruments with a maturity of [one year] or more

(B.2) Other instruments
Contracting States may consider under the conditions they prescribe, to be B.1 instruments, units in investment undertakings that hold the majority of their investments in instruments of category B.1 .

[*Optional*
Debt instruments mentioned sub (B.2) with a maturity of less than six months are excluded from the scope.]

[*Optional*
C.) **Derivative contracts** relating to financial instruments listed in A or B.1.and B.2 [and other financial instruments sub numbers of this paragraph §10.1] including securities giving right to acquire such financial instruments, or contracts giving right to a cash settlement determined by reference to such instruments, interest rates or yields,

indices, measures, events or other market elements that fluctuate in value, and including any other derivative contract relating to financial instruments, rights, obligations, indices and measures not otherwise mentioned in this article, which may not involve a transfer of ownership but have an equivalent effect (as a transfer of financial instruments) or has the characteristics of other derivative financial instruments and are traded as such;

[*Optional*: other than currencies][20];

[*Optional*: other than commodities, (investment) gold, climatic variables][21]

D.) Derivative instruments for the transfer of credit risk;

[*Optional*
E.) Currency of a State ;
Currency of a State shall mean the currency, bank notes and coins used as legal tender in a State with the exception of collection items; "collection items" shall be taken to mean gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest.

Contracting States of the European Economic and Monetary Union or the States who have a single currency are considered to be a State.]

Optional
F.) Derivative contracts relating to currencies including securities giving right to acquire or dispose of currencies or giving right to a cash settlement determined by reference to such currencies;

Optional
G.) Derivative contracts relating to commodities [and immovable property] including securities giving right to acquire commodities [or immovable property] or giving right to a cash settlement determined by reference to commodities[or immovable property];

Optional
H.) Derivative contracts relating to investment gold including securities giving right to acquire investment gold or giving right to a cash settlement determined by reference to investment gold;

Optional
I.) Derivative contracts relating to climatic variables, including emmission allowances including securities giving right to acquire emission allowances or giving right to a cash settlement determined by reference to climatic variables .

§10.2 Financial instruments listed above shall include instruments giving the holder thereof de jure or de facto rights of ownership or possession over such financial instruments or part thereof [or over the derivative contracts related thereto].

Consideration and taxable amount

Article 9

§1 The taxable amount shall be everything which constitutes the consideration which has been or is to be obtained by the transferor from the transferee or a third party in the execution of the transaction, whether in cash, in kind or otherwise. Where reciprocal payments are compensated the taxable amount shall be the amounts before compensation.

Amounts expressed in cash shall be converted into the currency of the Taxing State [published by the Central Bank of that State on the day before the payment].

[The taxable amount shall not be a notional value that serves as a reference in a derivative contract unless the value is effectively at risk of one of the counterparties].

In an exchange of financial instruments where the (payment of) consideration is not expressed in cash, the consideration is valued according to [the fair market value] of the financial instrument received at the time of the chargeable event.

§2 In the case of cancellation, refusal of total or partial non-payment, or where the consideration is reduced after the transaction takes place, the taxable amount shall be reduced accordingly under conditions which shall be determined by the Contracting State that levied the tax. However, in the case of total or partial non-payment, Contacting States may derogate from this rule.

20- Could be deleted if option sub E is applicable
21- Could be deleted if option sub G, H, I is applicable

Taxable event and chargeability of tax

Article 10

§1 The taxable event shall occur and the tax shall become chargeable to the taxable persons or the persons liable to tax when the transaction is settled. A transaction is settled when the financial instrument is transferred and the consideration is paid.

§2 Where the terms of the transaction provides for successive payments or instalments the tax shall become chargeable at each payment.

§3 Where transactions are netted as defined in art 8§5 the taxable events of the transactions that have been netted occurs at the time of the netting and the tax on the transactions that are netted, shall become chargeable when the net payment or settlement takes place.

Rates

Article 11

§1 The standard rate of tax shall be fixed as a percentage of the taxable amount and shall, per transaction not be less than [0,05% or as may be agreed] for all transactions [other than transactions relating to instruments listed above in art 8§10 [sub E (currency) [where the rate will be not less than 0,01 [[that will be exempt [in a transitional phase] to the extent that the transactions are settled in cash within [three] days]]and] sub A (equity) where the rate will be not less than [0,2% or as may be agreed].

[*Option*: The standard rate of tax shall be fixed as a percentage of the taxable amount and shall, per transaction not be less than [0,05% or as may be agreed] for all transactions other than :

- for transactions relating to instruments listed above in art 8.10 sub A. (equity) where the rate will be not less than [0,5% or as may be agreed]
- for transactions relating to instruments listed above in art 8.10 sub B.1 (long term debt instruments) where the rate will be not less than [0,1% or as may be agreed]
- for transactions relating to instruments listed above in art 8.10 sub E (currency) where the rate will be not less than [0,01% or as may be agreed]

[OPTION: For transactions where a provider acting as a regulated Central Counterparty authorised to operate as such interposes itself between transferors and transferees and is registered as such with the Contracting States, the rate is reduced by half.]

§2 The rate applicable to taxable transactions shall be that in force at the time of the chargeable event.

§3 In the event of changes in the rates, Contracting States may:

- effect adjustments in the case provided for in paragraph 1 in order to take account of the rate applicable at the time of the entering or conclusion of the transaction.
- adopt all appropriate transitional measures.

§4 Where the taxable person transfers from being taxed in the normal way to a special rate or scheme or vice versa, Contracting States shall take all necessary measures to ensure that the taxable person neither benefits nor is prejudiced unjustifiably.

Tax territoriality of financial transaction

Allocation of taxing rights among Taxing States

Coordination of tax collection among Collecting States

Article 12

Taxing rights and tax collection competences

§1 A transaction taking **place within the territory** of a Contracting State shall be taxed by that State (the **Taxing State**) according to the principles in this article and **the tax shall be collected** within the territory of the State (**Collection State**) of residence of the person liable to tax or within the territory, according to the principles in art 13 and art 15, or in other States that agreed or obliged to assist the Taxing or Collecting States in the collection of their taxes .

Allocation - Avoidance of multiple taxation

§2 **In order to avoid double taxation** or multiple taxation the rights of taxation and the competence of tax collection of the Contracting States shall be allocated in the order of localisation of the transaction according to art 12 §6.

Contracting States shall exempt [or give a tax credit for FTT paid in] a transaction effectively taxed in another Contracting State that takes priority according to art 12§6.

Where transactions of a Single Entity are taxed as transactions of a Single Taxable Person, Contracting States shall in mutual agreement avoid double and multiple taxation according to the localisation of transactions as defined in art 12, apply simplified procedures according to art 14 and share the retained revenue according to art 3.

[§3 Nothing in this treaty prevents Contracting States to agree in bilateral or multilateral agreements to allocate their the rights of taxation and the competence of tax collection in a different way provided the different allocation does not affect the transfer of the revenues to the FTT Development Fund.]

§4 For the purpose of applying the rules concerning the place of a taxable transaction the person transferring the financial instrument and receiving the consideration shall be the **transferor** and the person to whom the financial instrument is transferred and paying the consideration shall be the **transferee**.

§5 An intermediary acting in own name shall be transferor or transferee as the case may be.

§6 **The place of a taxable transaction**

Territoriality counterparties

1. When **the transferor** of the financial instrument is resident within the territory of the Contracting States, the place of a taxable transaction shall be deemed to be the place where the transferor has his residence.

2. When the transferor is resident outside the territory of the Contracting States and the transferee is resident within the territory of a Contracting State, the place of the taxable transaction shall be deemed to be the place where **the transferee** has his residence.

Territoriality of transaction with bank intermediation

3. When the transferor and the transferee do not have their residence in the territory of one of the Contracting States and **the bank-intermediary** [that intermediates for the payments] is resident within the territory of one of the Contracting States, the place of a taxable transaction shall be deemed to be the place where the bank-intermediary has his residence or has a fixed establishment to which the bank-intermediation with respect to the financial transaction can be allocated, the Contracting State of the residence of the bank-intermediary of the transferor taking priority.

Territoriality of transaction with other financial intermediaries and providers of financial market infrastructure

4. When the place of the transaction is not according to art. 12§1(1) to (3) situated within the territory of a Contacting State, the place of a taxable transaction shall be deemed to bethe place where the institution, that performs one or more of the following functions with respect to the financial transaction, has its residence, if such place is situated within the territory of one of the Contracting States, **in the following successive order**:

- **in the post-trading phase:** the final settlement, the payment, the clearing,
- **in the trading phase:** the dealing or the brokerage [on behalf of clients], the [regulated] trading platform operated as a Central Counterparty, a Multilateral Trading Facility [or an Electronic Communications Network/ Crossing Network] that does not legally interposes itself as transferor or transferee;
- the booking in the accounts of an organised **registry of financial instruments**;
- **the messaging [system]**.

Territoriality of the financial instrument

5. When the place of the transaction is not according to art. 12§1(1) to (4) situated within the territory of a Contacting State, the place of a taxable transaction shall be deemed to bewithin the territory of **the Contracting State that issued** the financial instrument [or in

case of a currency exchange transaction, within the territory of **the Contracting State which currency** is a currency in the transaction,]or the Contracting State of which the person that issued the financial instrument is resident [and in case of a derivative contract, the Contracting State of which **the person that issued** the underlying financial instrument is resident] or when none of the criteria in this art 12§6(5) apply, the Contracting State of which the person that provides the domicile of the financial instrument is resident.

§7 [The place of transaction of a person acting whether or not in the name but **on behalf of another person** shall be the place where the intermediated underlying transaction has its place if the place of that underlying transaction is according to art 12§6 within the territory of a Contracting State; if the place of the intermediated underlying transaction is not within the territory of a Contracting State and the person acting on behalf of another person is resident within the territory of a contracting State, the place of the transaction will be that Contracting State.

§8 [For the purpose of preventing evasion, avoidance or abuse or in order to prevent double taxation, non-taxation or distortion of competition,] a Contracting States may, with regard to a transaction for which the determination of the place is governed by this article, consider the place of transaction, if situated outside the territory, as being situated within their territory if the **ultimate beneficiary** of the transaction has his residence within the territory of the State.

§9 For the purpose of preventing **evasion, avoidance or abuse,** Contracting States shall take the measures necessary to ensure that a trans¬action which would have been a taxable transaction if but for the evasion, avoidance or abuse it had been carried out within their territory by a taxable person or with the intermediation of a person listed in art 12§6 is treated as a transaction within its territory if the arrangement is made such that is less taxed, although it has the same or a similar effect as a taxable transaction.

Residence

§10 For the application of this treaty being **resident** or having a **residence** or establishment means having a residence, understood in the meaning of the residence concept of the OECD Model Tax Conventions, or a permanent address or a fixed establishment to which the transaction can be allocated.

Where a group of entities are treated as **one single taxable person** for the purpose of the FTT, the residence of the group entities is the Contracting State where the group entity is resident that can exercise ultimate control over the financial transactions of the group entities.

§11 Definitions: For the application of this treaty shall mean

- **Settlement:** the establishment, with the aim of completing a financial transaction, that the transfer by a transferor of a financial instruments and the payment in consideration by a transferee is effected
- **Clearing:** the process of establishing settlement positions, including the calculation of net positions, and the process of checking that financial instruments, cash or both are available. Clearing may involve netting, clearance and the settlement instruction
- **A banking – intermediary:** the institution that provides bank services and receives the payment or transfers the payment
- **Central counterparty:** an entity that interposes itself, directly or indirectly, between the transaction counterparties in order to assume their rights and obligations, acting as the direct or indirect buyer to every seller and the direct or indirect seller to every buyer
- **Trading platform:** the location of trading, which may refer to an exchange, MTF or an Electronic Communication Network / Crossing network
- **Exchange:** a trading platform where financial instruments are listed and trading takes place according to specified rules, providing a liquid market for trading
- **MTF or Multilateral Trading Facility:** a trading platform, other than an exchange, which provides trading in securities
- **Dealer:** an intermediary that provides trading services by trading on his own account
- **Broker:** an intermediary that undertakes trading activities on behalf of his clients

- **The domicile** of the financial instrument: the residence of the Issuer (International) Central Security Depository where the security is initially issued, or for financial instruments listed in art 8§10.1 (A) the residence of the financial centre of the primary market in which the equities are listed and for financial instruments listed in art 8§10.1 (B) the country code in the ISIN of the security.

Tax collection – persons liable for payment

Article 13

§1 Notwithstanding any provision in this treaty, Taxing States, with the assistance of Collecting States shall be entitled to collect and enforce the tax from any person liable to pay the tax as they see fit.

Persons liable for the tax of a taxable person are entitled to charge the tax to the taxable person, subject to agreement otherwise.

Counterparties as taxable persons

§2 Taxable persons, wherever resident, who carry out taxable transactions shall be jointly and severally liable to pay the FTT to the authorities of the Contracting State (the Taxing State) of the place where the transaction takes place, [subject to the provisions of §3 or §5].

Without prejudice to joint and several liability towards the Taxing State, each taxable person shall pay an equal share of the tax, subject to an agreement otherwise that shall not affect their rightsof the State.

Reverse charge – acting on behalf of taxable persons – single entity as taxable person

§3 Where a taxable person is resident outside the Contracting States, the Contracting States will adopt arrangements whereby a person within their tax jurisdiction is liable to pay the tax of the non resident taxable person according to the provisions of this treaty.

An authorised resident tax representative of the non resident taxable person, the resident person on whose behalf the taxable transaction is carried out, the resident ultimate beneficiary or the resident taxable person who is a counterparty [under **a reverse charge mechanism**] shall be designated as such other person and shall be liable to pay the tax.

Where a group of entities is treated as **one single entity taxable person** all entities are jointly and severally liable to pay the FTT of the group entities. The liability to pay the FTT of the group entities is primarily upon the taxable person resident within the territory of the Contracting State and that can exercise the ultimate control over the taxable financial transaction.

Joint and several liability of the intermediaries in the transaction chain

(Third party tax collection: FTT-Collecting Agents)

§4 Persons[whether resident or not within the taxing jurisdiction] other than the taxable persons shall be jointly and severally liable with the taxable persons for payment of the tax

- when the other persons act on behalf of a taxable person, execute, pay or settle wholly or partly the transaction or
- when they are according to art 12 §6 (3) and (4) a connecting factor to determine the place of a taxable transaction within the territory of the Taxing State,

These other persons shall be **designated “FTT Collecting agents”.**

Persons **netting** the transactions, transfers or considerations before settlement shall be jointly and severally liable if the provider of the final settlement of the transaction has not been informed of the taxable transactions, transfers or considerations before netting by the person netting the transactions, transfers or considerations before settlement .

Single entity as FTT- Collection Agents

Where a group of entities is treated as **one single person liable for the payment of the tax** all entities are jointly and severally liable for the payment.

Without prejudice to the joint and several liability of the group entities towards the Taxing State, the liability to pay the tax of the group entities is, unless otherwise agreed, upon the taxable person that can exercise the ultimate control over the taxable financial transaction and isresident within the territory of the Contracting State.

Non resident FTT-Collection Agents resident in a Collecting State within the M-FTT zone

Where the FTT-Collection Agent is not resident of the Taxing State the tax collection on behalf of the Taxing State shall be monitored and enforced by the Contracting State where the FTT-Collection Agent is resident, the Collection State. In such case, and without prejudice to art 14§2 on the One Stop Scheme, the FTT can be paid to the **Collecting State.**

The FTT may also be collected by other States that have agreed to or are bound by international instruments for the assistance of tax collection across the border.

Successive order of obligation to collect and remit the FTT by FTT- collecting agents

§5 Where one of the taxable persons or the person acting on his behalf in the realisation of the taxable financial transaction, directly or indirectly called upon the intermediation of a financial intermediary, including a provider of financial market infrastructure, as listed in art 12§6(3) and (4) which is according to art 13§4 a FTT-Collection Agent, and except where a taxable person is a financial intermediary or provider of the financial market infrastructure that is a **counterparty** in the transaction in which case this taxable person **shall withhold and remit the FTT,** the FTT shall, at the discharge of the obligation of the taxable persons to remit the tax to the tax authorities, be collected and be remitted on behalf of the taxable persons by the FTT-Collection Agents, **whether resident or notaccording to the following successive order** and without prejudice to the joint and several liability towards the Taxing State:

1. the bank-intermediary as meant in art 12§6(3) irrespective of its residence, the bank-intermediary of the transferor taking precedence,

2. the person that performs one or more of the following functions with respect to the financial transaction, **in the post-trading phase:** the final settlement, the payment, the clearing, **in the trading phase**: the dealing or the brokerage [on behalf of clients], the [regulated] trading platform operated as a central counterparty, a Multilateral Trading Facility or an Electronic Communication Network/ Crossing Network that are not legally interposed as transferor or transferee;

3. the person that performs the booking in the accounts of an organised **registry of financial instruments;**

4. [the person that operates **the messaging [system]]**.

Notwithstanding any agreement otherwise, an FTT-Collection Agent shall be entitled to withhold the tax from the taxable transaction or be entitled to have the tax remitted by the taxable persons or the persons acting on their behalf. The FTT-Collection Agent shall not be entitled to realise his financial intermediation or provision of infrastructure if the FTT cannot be so withheld or remitted.

The Contracting State may subject the FTT-Collecting Agent [and taxable persons] to guaranties.

§6 Contracting States shall adopt mutual arrangements to avoid double and multiple taxation a.o. by providing for the registration of the taxes paid through a common electronic mechanism, a [liberalising] **electronic FTT-tag** relieving in the transaction chain the other intermediaries or providers of infrastructure listed in §5 from their obligation towards the tax authorities to collect and remit the FTT and the taxable persons mentioned in §1 and §2, and without prejudice to the right to of the tax collecting agent who remitted the tax, to withhold or have the tax remitted by the taxable persons, unless otherwise agreed.

§7 Tax Collection and Compliance

(1). Every person liable for payment of the tax shall submit a return to the Taxing States within an interval to be determined by each Contracting State [but not less than ten days after the end of the past quarter of a calendar year]. Contracting States may fix shorter periods for different categories of persons, taxable transactions or financial instruments. The return must set out all the information needed to calculate the tax that has become chargeable and in so far as it seems necessary for the establishment of the tax basis, the total amount and volume of the transactions before netting. Contracting States may prescribe to submit returns electronically.

(2). Every person liable for payment to the tax authorities of the Taxing or Collecting States or, under the control of the authorities of the Taxing States to the FTT-Development Fund shall pay the tax when submitting the return, or at the time an electronic FTT-tag is attributed. The Contracting States may, however, fix an earlier date for the payment of the amount or may require an interim payment.

(3). Contracting States (Collecting States) shall take the necessary measures to ensure that those persons who are considered to be liable to pay the tax instead of a taxable person established in another country or who are jointly and severally liable for the payment, shall comply with the above obligations relating to declaration and payment to any of the Taxing or Contracting States.

Optional schemes for simplification

Article 14

§1 Contracting States which might encounter difficulties in applying the normal system of taxation to taxable persons by reason of the non-resident status of the taxable persons or persons liable to tax, the single entity approach or the activities on the retail market, shall have the option, under such conditions and within such limits as determined in annex of applying simplified procedures such as schemes and special rates for collection and remittance of the tax in one or more Collecting States of Choice, through a tax representative, at the **single entity level** or at **a whole sale market level,** including for the currency transactions a fiat-rate schemes for charging and collecting the tax at the whole sale market, provided the schemes do not lead to a reduction of the tax .

§2 One stop compliance system in a State of Choice
Contracting States shall permit a taxable person, a group of taxable persons, a single entity or a person liable to tax that operate in several other Contracting States, or intermediate in transactions that take place in other Contracting States than the State where it is resident, or that have no residence in the territory of the Contracting State and who is liable to pay the tax to fulfil its obligations per type of transaction or category of financial instruments listed in art 8 or per category of functions listed in art 12 in one or more Contracting State of its choice, the **Collecting State of Choice,** in which the person registers as such and complies with the obligations relating to declaration and payment of the FTT as provided in this treaty and by the Taxing States concerned and the Contracting State of Choice.

The person shall submit by electronic means to the Collecting State of Choice a FTT return for each calendar quarter which shall show, for each State where transactions in which FTT is due, the value, exclusive of FTT, of taxable transactions carried out during the tax period and the amount of the corresponding FTT, the applicable rates of FTT and the FTT due. The FTT return shall be made out in their national currency by applying the exchange rates published by the Central Bank of the Collecting State of choice.

The person shall pay the FTT to the Collecting State of choice [when the electronic FTT-tag is attributed or] when submitting the FTT return.

The person shall keep records of the transactions covered by this special scheme. Those records must be sufficiently detailed to enable the tax authorities of the Taxing or Collecting State where the FTT is due to verify that the FTT return is correct. The records must be made available electronically on request to the Collecting State of choice and to the Contracting State (Taxing and Collection State) where the FTT is due.

§3 The Collecting State of choice shall forward half of the Y percentage of the revenue as meant in art 4§2 to the State where the FTT is due and X% as agreed under art 4§1 to that State or to the Common FTT- Development Fund.

§4 Contracting States may **release** taxable persons or persons liable for payment :

- from certain compliance obligations,
- from the payment of the tax due where the amount of tax is insignificant or the annual volume of financial transactions is below the threshold of the money laundering legislation[22].

22- 15.000,00 €

[*Option:* Contracting States shall grant an exemption from tax not withheld by third parties liable to pay the tax, to taxable persons whose annual taxable amount is at the maximum equal to the equivalent in national currency of 10.000 euro or 1000€ tax per annum at the conversion rate of the day on which this convention enters into force.]

[*Option:* Contracting States may exclude [for a transitional phase under the conditions the Contracting State may determine] from the scope of the FTT transactions by retail investors, i.e. individuals who invest in securities in their own account, and retail financial transactions related to non-financial transactions [in both situations up to transactions below USD 1 million].

Measures to ensure the correct application of the tax and the prevention of fraud – international cooperation

Article 15

§1 National measures of enforcement and measures against tax avoidance & evasion

Without prejudice to the provisions to be adopted pursuant to article [13] and this article, Contracting States apply and introduce all measures and impose all obligations which they deem necessary for the correct levying and collection of the FTT and for the prevention of tax avoidance and fraud, including the imposition of administrative fines and penal prosecution and shall apply their national provision for the enforcement of national taxes equally to the enforcement of the FTT, including to collect as Collecting State the FTT on behalf of a Taxing State as agreed in this treaty.

§2 International cooperation for the control and collection of the tax

2.1. Contracting States shall fully co-operate with other Contracting States, the FTT advisory committee and other institutions or persons duly authorised for the proper application and enforcement of the FTT. The cooperation under this treaty shall take place on the basis of reciprocity.

2.2. Contracting States agree to assist the other Contracting States in the investigation, assessment and collection of the FTT according to the rules contained in the Council of Europe /OECD Convention on Mutual Administrative Assistance in Tax Matters, concluded in Strasbourg on 25 January 1988 as amended on 27 May 2010 and in the provisions on mutual assistance and collection in the bilateral and multilateral tax conventions according to the OECD and UN Model Conventions and other binding regional and international instruments and apply these rules mutatis mutandis to the FTT [or agree to include the M-FTT in the scope of these agreements].

The Contracting States agree to expand and organise the automatic and spontaneous exchange of information, including electronically, of the [existing] international instruments for the exchange of tax information, to information relevant for the application of the FTT .

2.3. The Contracting States shall (as Collecting State) mandate and instruct the persons within their jurisdiction liable to the FTT of the other Contracting States (Taxing States) to withhold or have them transmitted the FTT and to transfer the FTT to the appropriate other State or the FTT Development Fund.

The Contracting States authorise as Collecting States other persons, including its own authorities, within its jurisdiction to provide all information relevant for the assessment of the FTT to the other Contracting States as Taxing States.

2.4. Contracting States (Collecting States) agree, under their authority and subject to their supervision and as to the investigation on its territory, upon authorisation on a case by case basis, to the [cross border] investigation, assessment and collection of the FTT of other Contracting States (Taxing States) payable by persons liable to the FTT.

2.5. The Contracting States agree to co-operate, and to have the persons within its jurisdiction cooperate with the bodies established by the Council for advise, coordination, inspection, evaluation and investigation of the application of the FTT.

§3 Cooperation with financial authorities

The Contracting States shall enter into appropriate arrangements with institutions and other persons [that are vested with public authority over the financial markets and financial actors] for the cooperation on compliance, reporting of data on the financial transactions and intermediation, control and enforcement of the tax .

Contracting States shall authorise and mandate those institutions and authorities within its jurisdiction to cooperate to that effect with the other Contracting States and institutions so designated.

§4 Legal FTT prerequisites for the licence to participate to the financial markets and to market financial instruments

Contracting States shall introduce in the regulation of authorisation to participate on the financial markets and to market financial instrument the requirement that the financial market participant secures the payment of the FTT on all financial transactions where the financial market participant intermediates and that all financial instruments marketed on the financial markets are subject to FTT upon their transfer.

Notwithstanding other appropriate regulatory and other measures to sanction compliance, the Contracting States, where appropriate through their market authorities, shall where a pattern of non compliance is established, suspend or withdraw the authorisation to market financial instruments [or to operate as a financial market participant and to distribute the financial instrument].

§5 Non-enforceability of untaxed transactions

Contracting States shall not recognise in law nor assist the enforcement of a transaction, the conclusion or execution thereof nor the transfer of ownership nor agreements to act on behalf of a taxable person with respect to any financial transaction unless the payment of the FTT has been secured within the period of compliance. Payment of FTT will be considered to be a substantial condition of form of the transaction. Consideration paid without FTT compliance may be considered undue. Intermediaries are not authorised to settle and or clear the obligations of the contracting parties nor use the financial instrument as collateral if FTT is not paid.

In cases beyond the will of the taxable persons or persons liable to pay the tax or otherwise but subject to dissuasive compensatory payments, Contracting States may regulate, including penalise, a delayed payment preventing the application of this paragraph.

§6 Audit responsibilities of the external auditor of the (consolidated) annual accounts

The Contracting States shall impose on the external auditors of taxable persons and persons liable to tax including Single Entities, to certify according to general audit standards and specific regulations, if provided for, that the audited persons are in compliance with the M-FTT obligations.

Auditors resident in the Contracting States who are part of an international network of auditors shall require from their colleagues who audit the consolidated accounts of the main establishment of the consolidated group of enterprises the certification that the consolidated group or those entities of the group within the territories of the M-FTT, including those entities that are under control of the entities resident within the territories of the Contracting States, are in compliance with the M-FTT obligations. Where no such certification can be given the competent Financial Authorities shall be informed and those authorities shall inform the competent Tax Authorities.

§7 Information duties of the investment advisors and consulting professions

Contracting States will extend the applicability of existing regulations and international agreements on the duty of investment advisors and consulting professions to inform the Financial Intelligence Agencies on serious financial crimes to serious breaches of the M-FTT legislation.

§8 Measures and International Cooperation [against] organised financial M-FTT crimes

1. Contracting States will extend the applicability of the regulations and international agreements to combat *money laundering* and financing of terrorism to serious breaches of the M-FTT regulations and authorise the Financial Intelligence Units, organised under those regulations and agreements, to preventive monitor and investigate and to cooperate internationally to support a proper application and enforcement of the M-FTT legislation and the prosecution of serious breaches thereof.

2. Contracting States will extend the applicability of existing regulations and international agreements on *judicial and administrative cooperation on criminal matters* to serious breaches of the M-FTT regulations.

3. For the purpose of the application of this paragraph “serious breaches” shall mean the organised financial crimes as defined under the national measures and international agreements referred to in previous paragraphs, extended and applied mutatis mutandis to violations of the M-FTT regulations.

Technical advisory committee on FTT

Article 16

1. An advisory Committee on FTT, hereinafter called "the Committee", is hereby set up.

2. The Committee shall consist of, [15] experts appointed by the Council of which 8 designated from among tax authorities and financial authorities of the Contracting States and 2 designated from among representatives of the Civil Society and 2 designated from the financial sector. The chairman of the Committee shall be a representative of the Council. Secretarial services for the Committee shall be provided by the Council .

3. The Committee shall adopt its own rules of procedure.

4. The committee shall examine questions concerning the application of the Treaty provisions on FTT raised by its chairman, on his own initiative or at the request of one Contracting State or one fifth of the members of the Committee.

Part III The common fund for the finance of development

Article 17

§1 To pursue the objectives of this Treaty, Contracting Parties establish a FTT Development Fund for the finance of development under the management of the Council.

§2 The funds of the Global Fund shall be used to finance Development and the provision of globalcommon goods undertaken by States or other legal persons as decided by the Council.

Part IV Governance

Council of States

Article 18

§1 There shall be a Council of States comprised of the representatives of the Contracting States.

§2 The Council shall facilitate the purpose and the operation of this Treaty. To this end, it shall:

a. carry out the functions assigned to it under this Treaty

b. at the request of a Contracting State, clarify the interpretation or application of this Treaty

c. consider any matter that may affect the operation of this Treaty; and

d. take such other actions as it deems necessary to fulfil its mandate;

§3 In carrying out the functions specified in paragraph 2 the Council may consult governmental and non-governmental organisations or persons [and shall consult with a body of representatives of civil society, that organise themselves on the basis of a regulation decided by Council, and with representatives of Developing Countries as agreed upon by Council before final decisions on the use of the funds are taken].

§4 The Council shall elect a Chair, who shall serve in a personal capacity. Meetings shall be held at intervals to be determined by the Council. Council shall establish its rules and procedures.

§5 The Council shall make decisions by consensus. Such decisions may include a decision to adopt a different voting rule for a particular question or category of questions. A Contracting State may abstain and express a differing view without barring consensus. Each Contracting State shall have one vote if their population amounts to less than 10 million people, two votes if more than 10 million but less then 100 million people and 3 votes if more than 100 million people.

§6 The Council shall be assisted by a Secretariat.

Financial regulations

Article 19

§1 Except as otherwise specifically provided, all financial matters related to the Council, including subsidiary bodies, and the meetings of the Council including its Bureau shall be governed by this Treaty and the a Financial Regulations and Rules adopted by the Council.

§2 Expenses of the Council, including subsidiary bodies shall be paid from the Global fund.

§3 The contribution of Contracting States shall be assessed in accordance with agreed scale of assessment, based on the scale adopted by the United Nations for its regular budget and adjusted in accordance with the principles on which that scale is based.

§4 Without prejudice to paragraph 3, the Fund may receive and utilise, as additional funds, voluntary contributions from Governments, international organisations, individuals, corporations and other entities, in accordance with relevant criteria adopted by the Council.

Part V
Final clauses

Article 20
Settlement of disputes

Any dispute between two or more Contracting States relating to the interpretation or application of this Treaty which is not settled through negotiations within three months of their commencement shall be referred to the Council. The Council may itself seek to settle the dispute or may take recommendations on further means of settlement of the dispute, including referral to the Councilor to the International Court of Justice in conformity with the Statute of that Court.

Article 21
Reservations

No reservations may be made on this Treaty other than under art 26 §3.

[Nothing in this Treaty shall be construed to restrict an obligation of a Contracting State Party under the Treaty establishing the European Community, concluded on 25 March 1957 in Rome, as amended from time to time]

Article 22
Amendments

§1 After the expiry of three years from the entry into force of this Treaty, any Contracting State may propose amendments thereto. The text of any proposed amendment shall be submitted to the Secretary-General of the United Nations, who shall promptly circulate it to all Contracting States.

§2 No sooner than three months from the date of notification, the Council, at its next meeting, shall, by a majority of those presents and voting, decide whether to take up the proposal. The Council may deal with the proposal directly or convene a Review Conference if the issue involved so warrants.

§3 The adoption of an amendment at a meeting of the Council or at a Review Conference on which consensus cannot be reached shall require a two-third majority of Contracting States.

§4 Except as provided in paragraph 5, an amendment shall enter into force for all Contracting States one year after instruments of ratification or acceptance have been deposited with the Secretary-General of the United Nations by seven-eighths of them.

§5 Any amendment to articles of this Treaty shall enter into force for those Contracting States, which have accepted the amendment one year after the deposit of their instruments of ratification or acceptance.

§6 If an amendment has been accepted by seven-eighths of Contracting States in accordance with paragraph 4, any Contracting State which has not accepted the amendment may withdraw from this Treaty with immediate effect, notwithstanding article 27 §1 but subject to article 27 §2, by giving notice to the Secretary General of the United Nations of a two years period of re-consideration.

§7 The Secretary-General of the United Nations shall circulate to all Contracting States any amendment adopted at a meeting of the Council or at a Review Conference.

§8 Amendments to provisions of this Statute, which are of an exclusively institutional nature, may be proposed at any time, notwithstanding article by any Contracting State. The text of any proposed amendment shall be submitted to the Secretary-General of the United Nations or such other person designated by the Council who shall promptly circulate in to all Contracting States.

§9 Amendments under this article §8 on which consensus cannot be reached shall be adopted by the Council or by a Review Conference, by a two-third majority of Contracting States. Such amendments shall enter into force for all Contracting States six months after their adoption by the Council or, as the case may be, by the Conference.

Article 23
Review of the Treaty

§1 When the Contracting States account for at least [---%] of the Global Financial Markets as established by the Council, its Bureau shall convene a Review Conference to consider any amendments to this Statute. The Conference shall be open to those participating in the Council and on the same conditions.

§2 At any time thereafter, at the request of a Contracting State and for the purposes set out in paragraph 1, the Secretary-General of the United Nations shall, upon approval by a majority of Contracting States, convene a Review Conference.

§3 The provisions of article 22, shall apply to the adoption and entry into force of any amendment to the Statute considered at a Review Conference.

Article 24
Signature, ratification, acceptance, approval or accession

This Treaty shall be open for signature by all States in New York, at the United Nations Headquarters.

§1 This Treaty is subject to ratification, acceptance or approval by signatory States. Instruments of ratification, acceptance or approval shall be deposit with the Secretary-General of the United Nations.

§2 This Treaty shall be open to accession by all States. Instruments of accession shall be deposited with the Secretary-General of the United Nations.

Article 25
The Preparatory Group

§1 Until the entry into force of the Treaty there shall be a Preparatory Group comprised of the Signatories to the Treaty.

§2 The Preparatory Group shall:

a. prepare for entry into force of the Treaty

b. prepare for the establishment of the Council and the secretariat of the Council.

The Preparatory Group shall elect a chair, who shall serve in a personal capacity.

§3 The Preparatory Group shall establish its rules and procedures. Meetings shall be held at intervals to be determined by the Preparatory Group.

§4 The Preparatory Group may receive and utilise volunteer contributions from governments, international organisations, individuals, corporation and other entities. It shall make public in annual accounts the reception and utilisation of the funds.

Article 26
Entry into force provisional period

§1 This Treaty shall enter into force on the first day of the month after the [---]th day following the date of the deposit of the [---]th instrument of ratification, acceptance, approval or accession with the Secretary-General of the United Nations, or on the date on which the Preparatory Group has [established] that the Contracting States who have ratified the Treaty account for at least [---] % of the global financial markets, whichever is later.

§2 For each State ratifying, accepting, approving or acceding to this Treaty after the deposit of the Xth instrument of ratification, acceptance, approval or accession, the Statute shall enter into force on the first day of the month after the [---] th day following the deposit by such State of its instrument of ratification, acceptance, approval or accession.

§3 Any Contracting State may declarebefore the treaty enters into force into its jurisdiction that it reserves the right to apply the treaty for a provisional period [of not less than --- years] which that State determines and which that State may upon an evaluation, prolong by a period of not less than [---] years. The reservation and the prolongation shall be addressed by notification to the Secretary-General of the United Nations.

Article 27
Withdrawal

§1 A Contracting State may, by written notification addressed to the Secretary-General of the United Nations, withdraw from this Treaty. The withdrawal shall take effect two years after the date of receipt of the notification, unless the notification specifies a later date.

§2 A Contracting State shall not be discharged, by reason of its withdrawal, from the obligations arising from this Treaty while it was a Party to the Treaty, including any a Financial obligations, which may have accrued. Its withdrawal shall not affect any co-operation in connection with investigations and proceedings in relation to which the withdrawing State had a duty to co-operate and which have commenced prior to the date on which the withdrawal became effective, nor shall it prejudice in any way the continued consideration on any matter which was already under consideration prior to the date on which the withdrawal became effective.

Article 28
Authentic texts

The original of this Statute, of which the Arabic, Chinese, English, French, Russian and Spanish texts are equally authentic, shall be deposit with the Secretary-General of the United Nations, who shall send certified copies thereof to all States

In witness whereof, the undersigned, being duly authorised there to by their respective Governments, have signed this Statute.

Key issues in designing a financial transaction tax (FTT)

Avinash Persaud[23]

It is sometimes argued that since it is difficult to design a financial transaction tax that would be entirely immune from the ill-placed ingenuity of bankers there is no point in doing so. This is a much higher benchmark than we apply to almost any other tax. One of the principal sources of tax revenues in the United States is income tax, but the last study by the IRS suggested that non-compliance with the tax code amounted to $345bn and 18-19% of income was not properly reported to the IRS. Other studies suggest this number has grown to $500bn[24]. Yet this non-compliance is not seen as a sufficient reason for abandoning income tax collection altogether. Eighty two percent compliance is not as good as it should be but the $2,000bn that is actually raised and spent is not to be dismissed. An important aim in the design of FTTS must be to minimize avoidance and evasion, but there should be an acceptance that minimizing it to zero is not practical for any tax.

Legal Enforceability and Stamp Duties

The way to minimize tax avoidance and tax evasion in a financial transaction tax is the same as with all taxes and other white-collar crimes. It was well described over dinner by Botswana President, Festus Mogae, as turning the undesired activity from a high return, low risk venture, into a low return, high risk one. In the case of FTT, this means a low tax rate coupled with high consequences of non-compliance.

Across the world where 'stamp taxes' are collected[25], a non-taxed, and therefore non-stamped financial transaction, cannot be legally enforced so there can be no registered change of ownership until taxes are paid to, and stamped by, the authorities. These stamp taxes are collected at settlement where change in registered ownership takes place. They are a levy on the transfer of legal ownership not the transactions per se. Non-enforceability of contract is a very high consequence of non-compliance with the stamp duty. It is particularly so where registered owners of assets are due to receive certain benefits and rights like voting at shareholder meetings, dividends, interest coupons, rights issues or buy-outs.

New Regulatory Requirements and Central Clearing

Instruments that are non-taxed, and are therefore not legally enforced, cannot be considered eligible for central clearing by a clearing house. This is of crucial importance today. It represents one of the ways that FTTs are more feasible than ever before. One of the responses by the G20 and the Financial Stability Board to the financial crisis is a regulatory requirement that all exchange-traded instruments (including

23- Senior Fellow, London Business School, Emeritus Professor of Gresham College and Chairman, Intelligence Capital Limited. Many people contributed to the background research to this paper, especially, Richard Gower.

24- See Richard Cebula and Edgar Feige "America's Underground Economy: Measuring the size, Growth and Determinants of Tax Evasion in the US. (http://www.ssc.wisc.edu/econ/archive/wp2011-1.pdf)

25- Stamp taxes have a long tradition in many countries including Malaysia, Netherlands, Ireland, Israel, UK and the US.

equities, bonds, derivatives and all vanilla over-the-counter transactions such as CDS) must be centrally cleared. Instruments held by financial instruments that are not centrally cleared will incur a capital adequacy requirement[26].

The consequences therefore of holding non-taxed instruments in terms of loss of legal certainty, higher counter-party risk, loss of gains from netting in a clearing house, and the cost of higher capital adequacy requirements for holding them, are quite substantial. It is estimated that over 70% of OTC credit derivatives will be centrally cleared and those that are not, are highly bespoke complex contracts that the clearers refuse to accept and as a result are more expensive for investors to hold. These non-centrally cleared instruments would still, of course, be subject to the tax and the underlying contracts would be unenforceable if the transfer of ownership was not stamped by the tax authorities. Even if an investor were prepared to take all of the risks – for the sake of saving a small fraction of one percent – they would then have to find another, equally prepared to do so, so as to exit from their investment with a return. Non-compliance will be a high-risk venture. Too high a risk, to be sure, for the banks, insurance companies, pension funds and mutual funds that dominate the financial markets.

To be resistant to evasion and avoidance, it would be best for a FTT to be a small, stamp tax on all financial transactions, with the sanction of unenforceability of contract for unstamped transactions.

Optimal Size, Elasticities and Distortions

→ A small tax will reduce the potential of economic distortions. One way of measuring this is estimating the elasticity of demand to changes in transaction costs – the amount that demand for an instrument will fall following a rise in transaction costs – caused by anything, including higher clearing house fees or an FTT. Our intention, so as to minimize distortions, would be not to change substantially the underlying demand for instruments. A number of studies have tried to estimate the price elasticitiesof one country imposing a transaction tax[27]. These studies indicate that the elasticities of demand for equities, for example, are in the region of 0.25 to 1.65, averaging around 1.0 so that a 1% rise in costs will lead to a 1% fall in volume.

This is a small elasticity of demand. It is likely to be an under-estimation of the effect of larger than 1.0% rises in stamp taxes, but also likely to be an over-estimation of the effect of much smaller rises. Below a certain size of transaction costs, the level of general uncertainties, including the likelihood of the asset price changing during the transaction period, means that there comes a point where thegains from a further reduction in transaction costs cannot be reliably obtained and yield marginal impact. (Similarly, because of these uncertainties, the investment literature generally shows that where nothing else changes, small changes in the short-term cost of capital, like the ones we are discussing here, have little impact on investment demand[28].)

The effect on demand of an instrument will also depend on a number of other factors that the studies on elasticities tend to neglect. Elasticity of demand would be smaller the more related countries, participate, thereby reducing the substitution effect captured in the studies. Further, the elasticity would be depend on who the investor is. The elasticity of demand for a volatile instrument, by a long-term investor who is hedging this volatility across time, from a small rise in transaction costs, would be far smaller than the elasticity of demand for instruments with generally lower, volatility, of high-frequency traders.

Commentators have argued that it is customers who ultimately pay the tax. This is correct. However not all consumers of financial products will pay equally. Long-term equity investors who roll over their portfolio once or twice a year will pay least and will be least affected, while short-term speculators

26- **The Communique, issued after the G20 meeting in Pittsburgh in September 2009, states:** "all standardized OTC derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest," "OTC derivatives contracts should be reported to trade repositories," and "non-centrally cleared contracts should be subject to higher capital requirements."

27- For a recent review of the results of these studies, see McCulloch and Pacillo (2010).

28- For an interesting study on the elasticities of investment in general to transaction taxes where the potential for substitution is high, see "Taxes, the Cost of Capital, and Investment:A Comparison of Canada and the United States." Kenneth J. McKenzie and Aileen J. Thompson, April 1997.

who roll over their portfolios several times a year, and are speculating on Government interest rates or currencies where transaction costs are currently low and elasticities are higher, will pay the most.

This is considered an attractive feature by many and was one of the arguments used originally by John Maynard Keynes and James Tobin in arguing for transaction taxes[29].Their intention was to cause a distortion to demand for instruments not to shy away from it.The counter-argument is that this would undermine financial liquidity and so soon after the crisis this is a seductive argument. But it is somewhat specious. While high turnover is one symptom of liquidity, financial market liquidity is ultimately about diversity. Liquidity exists where when you want to sell, someone else wants to buy, because they have a different valuation or investment goal or strategy. Algorithmic high-frequency trading is primarily trend following so that they are buyers when markets are rising and sellers when markets are falling, which reduces diversity and saps liquidity.[30]

Taxing Different Instruments

To reduce substitution, not penalize one financial instrument over another, and to maximize tax collection while minimizing tax rates, the tax should be collected across all financial instruments. The non-enforceability rule or inability to clear unstamped instruments would bite just as hard for a contract for difference as it would for an equity purchase. But it would be wrong to tax all instruments to the same extent. Across different instruments the tax should be sized to reflect, in general terms, their underlying elasticity or short-term volatility so as to reduce potential economic distortions. The tax should be highest where the elasticity is low and demand will be relatively unaffected, and lowest where the elasticity is highest and demand would be more affected[31].

Analysis of different elasticities[32] suggests that a reasonable range, erring on the side of caution, of the ratio of the tax in equities, bonds and short-dated bonds should be five to one for equities to long-dated bonds, and two to one from long-dated bonds to short-dated bonds. Hence, if there were a 0.50% tax on equities, the tax on long dated bonds would be 0.1% and the tax on short-dated bills, swaps and futures would be 0.05%. This analysis on the optimal size of the tax resonates with those transaction taxes that currently exist and appear most successful. It should be noted that a majority of foreign exchange transactions involve an underlying equity, bond or other instrument that would be stamped, with bonds and bills playing a particularly important role for those seeking the currency market “carry trade”. Consequently, extending the tax to bonds would effectively extend it to the currency markets.

Existing FTTs

Today, around $23bn is raised annually, by just seven countries, through FTTs. Almost half of this revenue is raised by the UK and South Korea alone where both have a 0.5% stamp duty on equities only – see table 1.

The ‘revealed preference’ from those countries that are raising significant sums is that tax rates are consistent with the analysis above:

(1) tax rates of 0.5% or below are not so high as to cause severe distortions or substantial avoidance and evasion, though as indicated earlier,some avoidance is expected;

(2) existing tax rates are not at the wrong end of the Laffer curve. At these rates, the higher the rate, the greater the revenue;

(3) tax rates levied on equity transactions are higher than on bonds by a multiple of 3 or 5 to 1. It is interesting to note that the ratio of equity to fixed-income or foreign exchange fees in clearing houses also ranges from 5:1 to 2:1.

29- One of the observations of Adair Turner, Chairman of the FSA, shared by others, is that the collapse of transaction costs towards zero, facilitated the creation of huge derivative markets balancing on relatively small underlying markets, which made financial systems more vulnerable in a crisis. The optimal level of transaction taxes may be low, but it is not zero. Mr. Turner is a supporter of transaction taxes.

30- This destabilizing behaviour is well described in “Positive feedback investment strategies and destabilizing rational speculation”, J. Bradford de Long, A. Shleifer, L. H.Summers and R. Waldman, Journal of Finance, June 1990.

31- This principle which maximizes the tax take, or producers surplus is also known as “Ramsey Pricing” after Ramsey (1927) and Edgeworth (1910).

32- See, Pollin, Baker and Schaberg, (2003).

Past taxing of bonds has been a little fraught, principally because bonds were traded over-the-counter, more bonds were bearer instruments, and short-dated bonds were cash-like. However, as cited above the universal trend towards trade-reporting, greater registered ownership under anti-terrorism finance, anti-money laundering rules and now central clearing and settlement, makes the task of taxing bonds similar to that of equities, while we must recognize, that lower volatilities, lower elasticities and lower trading spreads point to a lower tax rate than for equities.

SELECTION OF EXISTING STTs

Country	STT Revenue ($bn)	STT rates for different assets				
		Equity	Bonds/ Loans	Options	Futures	Capital Levy
Hong Kong	2.79	10 basis points				
India	1.22	0.25% on stock rice; 0.025% on intraday transactions; local stamp taxes may also apply	Local stamp duties may apply	0.017% on premium; 0.125% on strike	0.017% of delivery price	
South Korea	6.08	0.5% on value of shares in corporations or partnerships				0.1-0.4% tax on capital formation
South Africa	1.41	0.25% of value; new share issues excluded				
Switzerland	2	15 bps on domestic shares; 30 bps on foreign shares	6-12 bps on bond issuance			1% on share issuance in excess of CHF 1 mn.
Taiwan	3.3	30 basis points	10 basis points on corporate bond principal	10-60 basis points on premiums	Up to 0.025 basis points on interest rate futures; up to 6 basis points on stock index and other futures	
UK	5.86	Stamp duty 0.5% on secondary sales of shares and trusts holding share		50 bps on strike price, if executed	50 bps on delivery price, if delivered	
Total	**22.66**					

Sources: IMF Working Paper 'Taxing Financial Transactions: Issues and Evidence' March 2011 and World Bank GDP Data, for all except Taiwan (source: Darvas and von Weisacker (2010), 'Financial Transaction Tax: Small is Beautiful', who quote figures from the Ministry of Finance).
Data is for 2009 for Hong Kong and Taiwan, for 2008 for India, South Africa and the UK, and for 2007 for all other countries (South Korea and Switzerland).

Section 31 Fees – US Securities Transaction Taxes

The table above ignores transaction taxes that are used to pay for specific, market related, regulatory functions. Arguably, except for how the funds are used, these 'fees' have exactly the same economic and financial effects as transaction taxes. Therefore the true collection of securities transaction taxes and fees around the world annually is likely to be far higher than $23bn.

The US SEC, the securities regulator, is self-funded by a transaction tax on the volume traded on exchanges. Many who rile against transaction taxes and argue that slight taxes will exact huge disrepair to markets are often unfamiliar with the fact that, without the sky falling upon us, the US SEC charges a 0.00257% tax on transactions that today raises $1bn annually to fund the SEC. This tax, so-called 'Section 31 fees', is named after Section 31 of the Securities Exchange Act of 1934[33] which empowers the SEC to exact such a levy. These fees were raised in 2010 from 0.0017% and are likely to rise again given the additional expenditure of the SEC. Clearing houses also charge fees of similar order on transactions (buying and selling)[34].

The table above does not reflect how taxes have fallen and risen over time. Stamp taxes are old, common taxes[35]. Before the financial crisis when the sector convinced us that nothing should stand in the way of more trading, some of these taxes were taken off or moderated as their yield grew large, as was the case of the US securities tax and the broad financial transaction taxes in Brazil. More recently some have been returned. History has shown therefore that this is a policy that can be tried, and, if it proves too costly, reversed relatively easily and quickly. The US Section 31 fees have been lowered nine times and raised seven times since 1934 without stir.

Proposal

Our analysis and the revealed preference of the manner and size of the current $23bn of stamp duties argues for a small stamp duty across financial instruments, collected at settlement, enforced by the threat of uneforcibility of contract, with the tax sized in accordance to the volatility hierarchy of markets.

A stamp duty of 0.5% on equity transactions, 0.1% on long-dated bond transactions and 0.05% on short-dated bond, swap or futures transactions, if adopted by France, Germany and Spain, would likely yield $15bn per year (see tables 2 and 3) from equity and government bond markets alone, while causing minimal distortions and limited avoidance.

These funds can be raised independently of other countries following suit. However, such a lead could be accompanied by a commitment of others to follow suit. These taxes can be presented as the way the countries raising them will meet their international obligations and others are welcome to follow or to present alternative plans, but doing nothing is not an option.

Within the G20, four countries already have FTTs – South Africa, South Korea, India and UK. There would appear to be interest in other G20 countries such as Mexico, Argentina, Indonesia, Turkey and Australia to introduce transaction taxes. Brazil's Congress leaders and President have signaled that it will re-impose a 0.38% tax on all financial transactions – to fund domestic health initiatives. India and South Africa could be persuaded to raise their transaction taxes to a new international target. Wider participation could raise the collection to over $20bn but those that would make most difference remain France and Germany.

33- Under Section 31 of the Securities Exchange Act of 1934, self-regulatory organizations (SROs) – such as the Financial Industry Regulatory Authority (FINRA) and all of the national securities exchanges (including the New York Stock Exchange and the American Stock Exchange) – must pay transaction fees to the SEC based on the volume of securities that are sold on their markets. These fees recover the costs incurred by the government, including the SEC, for supervising and regulating the securities markets and securities professionals.

34- http://www.cmegroup.com/company/files/CME_Fee_Schedule.pdf

35- The first stamp tax was first devised in the Netherlands in 1624 after a public competition to find a new form of tax.

GOVERNMENT DEBT

	Revenue ($m)	Market Turnover ($m)
Germany	1,588	6,580,000
Euronext Paris	1,348	5,586,000
Euronext Amsterdam	845	3,500,000
Euronext Brussels	1,569	6,500,000
Euronext Lisbon	362	1,500,000
Spain	845	3,500,000
Totals	**6,558**	**27,166,000**

Securities Transaction Tax rate	0.10%
Elasticity of size to transactions costs	-3
Pre-tax transactions costs	0.17%

EQUITY MARKETS

	Revenue ($m)	Market Turnover ($m)
Germany	3,821	1,528,491
Euronext Paris	3,939	1,575,773
Euronext Amsterdam	1,578	631,378
Euronext Brussels	297	118,616
Euronext Lisbon	148	59,027
Spain	3,760	1,504,052
Totals	**13,543**	**5,417,336**

Securities Transaction Tax rate	0.50%
Elasticity of size to transactions costs	-1
Pre-tax transactions costs	0.50%

* Data on turnover comes from Euronext for equities and National Treasuries for exchange and OTC Government bond turnover, except for the Dutch and Portuguese bond turnover figures that are estimated from MTS monthly turnover. Given that the bond markets are primarily OTC, these estimates are crude compared to the equity figures, but because we are not including corporate bonds, swaps, and derivatives, they are likely to be at the lower end of the range. Elasticity estimates and revenue formula come from McCulloch &Pacillo (2010). All data are converted to dollars using a rate of $1.45.

Conclusion

There are to my knowledge no other innovative forms of financing development that would yield this scale of funding for development ($15bn per year - $75bn in five years) and afford the one time opportunity to wrestle and beat some of the biggest public health ailments that so debilitate social and economic development in the world's poorest countries.

Global financial markets are the biggest beneficiaries of globalization, as a consequence, the sector has far outstripped the growth of the world economy and grown from around $3trn in 1985 to over $100trn today – despite the global credit crunch. Industry forecasts suggest the sector – growing rapidly in emerging markets today – will touch $200trn within the decade. In turn, globalization has provided a route for the economic advancement of many nations. But some countries, and some communities within other countries, are being left behind. The growing divide is both reflected and aggravated by public health challenges. These not only cause much human misery, they debilitate a country's productivity, rotting away the steps of the ladder out of poverty. It seems fitting that a contribution is made from the sector that benefits most from globalization to those that are being left behind by it. This is a contribution that is small relative to the activity of the sector but large relative to what the resources could be used for, and a contribution that if it were to prove debilitating to markets, could be reversed.

Others are better placed to identify what $75bn could buy if these funds were directed to specific purpose – such as the elimination of malaria, AIDS or tuberculosis. While hypothecation of tax revenues would probably face greater obstacles than raising them, the legitimacy of the tax will be strongly related to what it used for or at least ear-marked for from general funds. In this regard it is interesting that few blink at the idea of the SEC raising its transaction fees to pay for, hopefully, better regulation, or the Clearing Houses, raising their transaction fees in response to new regulatory requirements designed to reduce systemic risk. There are no long debates on avoidance, liquidity, or the implications of raising the cost of capital.

This briefing has examined the economic issues around FTTs. We conclude that a small stamp tax, where contracts are unenforceable if they are not taxed and stamped, and where it is imposed across financial instruments can raise $15bn with minimal distortion and avoidance if France and Germany and Spain adopt it and significantly more if others follow. In short, the economics does not get in the way of the development argument or the moral case. Others are better suited to espouse the moral case, but it would seem to me that while the cost of trying would be small; the costs of prevaricating, or forever promising but never delivering, of waiting till a tomorrow that never comes, are enormous.

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Derivatives

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It is often argued that if there is a tax on transacting financial instruments, market participants would switch to the derivatives market where the tax could not be levied. There are a number of reasons why this argument is suspect.

To begin with it is important to remember that there are many ways to evade and avoidthe taxes that contribute most to national treasuries: income, corporate, capital gains and sales taxes. The degree of avoidance of any tax depends in part on the size of the tax and the consequences of being "caught". In this case we are arguing about a small tax with large consequences if they are not paid. These consequences include the simple and traditional legal one, where contracts to buy or sell an instrument will be ruled unenforceable if the tax has not be paid. This is a tough consequence. The major end-owners of financial instruments, such as pension funds, insurance companies and the largest international banks could not, for a host of regulatory, risk-management and fiduciary reasons, hold instruments where their legal enforceability was in doubt. Indeed, an untaxed instrument would be ineligible for central clearing, a new requirement of all vanilla, OTC, derivative instruments, as well as equity and fixed-income instruments, which would cost the evader several times more than the tax. There could be further regulatory rules where instruments that were untaxed could not count as collateral or capital in the countries in which the tax was imposed.

It is easy to be mesmerized by the notional size of derivative markets. The credit derivative swaps market for instance is estimated to be $30trn, or almost double the size of the US equity. But thesemeasures of size can be an illusionary, often represent double-counting of gross notional positions while the value of net positions are often considerably smaller. Moreover, in most cases, derivative activity is not so disconnected from the underlying market and so transaction taxes would be paid. In large part, though by no means exclusively, derivative transactions are compliments to the positions in the underlying markets, not substitutes. This can be seen in the case of equity stamp duties that continue to raise large sums, even when they are surrounded by highly liquid and large equity derivative markets as in the case of the UK, Hong Kong, Taiwan, India, South Africa and South Korea.

In many cases a derivative position is a hedge against movements in an underlying holding for which the tax would have been paid. In cases where the derivative is the main focus, investors trade in and out of the underlying market – and hence would pay the tax – in order to hedge their derivative exposures. Imagine, a bank has sold a call option on GE shares to an investor so that were GE shares to rise above a certain level, the bank would be obligated to deliver $100m of GE shares to its customer at that level. Imagine that after current price action, the probability that the bank would have to do so and would be "short" $100m of rising GE shares, had risen from 5% to 50%. In order to limit the bank's potential loss from this derivative contract, the bank would buy some GE shares now, and in doing so, would pay the tax. The tax would have to be very substantial, certainly above 1.0%, for the bank to decide it would rather expose itself to a multi-million dollar loss, and collateral call and increased capital adequacy requirement than pay the tax.

However, not all derivative transactions will have some underlying transaction or series of underlying hedging transactions and consequently, a tax on the underlying transaction could lead to some substitution to the derivatives markets and a loss in tax revenues. Again the incentive to substitute will relate to the size of the tax savings and the cost of not holding the underlying instrument in terms of lost dividends or not having the right to vote in shareholder meetings. In this case, the tax authorities could take a leaf out of the historical approach to the transaction of bearer bonds, and tax the premium on derivative transactions at a rate of three times the rate of tax on underlying transactions, while giving a tax credit where taxes are then further paid in the course of hedging the instrument. This could also be set up as a withholding tax on the derivative premia, released in part or in whole if there are related, tax-paying transactions in the underlying instruments. In the GE case for instance, the bank would pay a tax on the premium earned for selling the call option on GE stock, and if greater taxes were paid in the selling and buying of GE stock to hedge this transaction, this tax would be returned (or credited against tax due).

In conclusion, derivatives are less of an obstacle to a financial transaction tax than many people think. First, derivates are often compliments to the underlying markets rather than substitutes and taxes on the underlying instruments can co-exist with healthy derivative markets as we already observe. Where derivatives are a hedge for an underlying instrument, or are themselves hedged by transactions in the underlying transactions a transactions tax would be collected. But this is not always the case today and may be less so in the future. To avoid substitution from the underlying markets to the derivative markets to avoid paying the tax, a withholding tax can be placed on the premium paid for derivative transactions at a "penal" rate of three times the normal rate for a transaction (derivative premia are far smaller than the notional value of the transaction) and this can be refunded in part or in whole if there are related, tax-paying transactions in the underlying markets. The penalty for avoiding or evading the tax would be the same as elsewhere, the contract underlying the untaxed instrument would be unenforceable in jurisdictions that have signed up to the tax which would be a cost and risk far outweighing the cost of paying the tax.

A successful and doable multilateral financial transaction tax (M-FTT)

Bruno Jetin[36]

The present note highlights some critical points for the success of a multilateral financial transaction tax (M-FTT). The crux of the matter is that the tax will be naturally incorporated in the present organisation and working of financial markets. There is no technical or economical obstacle to the tax.

1. General features of the M-FTT

The success of the M-FTT depends on its scope and simplicity. The M-FTT must be as comprehensive as possible to avoid fiscal fraud, discrimination between markets and economic agents, and delocalisation of financial activities and jobs. The tax rates must be high enough to generate substantive revenues and no too high to avoid a dramatic reduction of the volume of transaction which would run contrary to the objective of raising revenues and improving the stability of financial markets.

A comprehensive tax

To avoid fraud and discrimination between markets, the tax should be applied on all financial markets, to all market players and to all financial instruments: bonds, equities, money, currency and commodities. Each exception will not only infringe the principle of non-discrimination, it will also create loopholes and possibilities to circumvent the tax on the markets where it is levied. By the same token, the tax must apply to whole financial instruments. The possibility to revise the Treaty regularly will open the possibility to include any new financial instruments.

The only exception to the rule is the distinction between primary and secondary markets for bonds and equities but not for other markets such as the currency market where such a distinction is not relevant. On the primary markets, bonds and equities are issued for the first time by firms or states to satisfy financing needs. The objective of the tax is not to disturb in any way the economic process by which firms for instance issue shares or bonds to finance investment and create jobs. It is not the case of secondary markets where the same shares and bonds are sold again and again to different owners. Quite to the contrary, taxing secondary markets makes possible to tax the practice of share buy-backs which is detrimental to job creation because it diverts profit from productive investment. It may also encourage investors to keep their bonds and shares for a longer period and contributes to financial stability. And finally, secondary markets are by far the biggest markets where the tax can produce important revenues.

A neutral tax

Taxing all markets and financial instruments does not mean that the same rate will be applied. The tax will be considered as a transaction cost by market players. A significant increase in the transaction cost reduces the number of transactions. So the tax rate has to be weighed against the pre-tax transaction cost which is different according to asset/product and market players. To respect the principle of neutrality between markets and financial instruments, the introduction of the tax should increase the transaction cost in the same proportion, (from 30% to 50%) in all markets and for all financial instruments. The tax rate will be different for each broad class of instruments (bonds, shares, currencies, …) but the effect on the volume of transactions will be the same. The tax rates given in the blueprint are inspired by this philosophy and therefore respect the equal treatment principle.

It follows from what precedes that ideally all States should adopt the same tax rates for each financial instrument, if they have the same pre-tax transaction costs. If not, investors would be induced to migrate in the taxing states where tax rates are lower.

A tax that avoids multiple taxation

The fact that the M-FTT is a comprehensive tax creates the risk of taxing the same transaction several times. The blueprint proposes the creation of a liberalising electronic tag

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"attached to any financial transaction on which the M-FTT has been paid relieving the other intermediaries in the transaction chain, and thereby ensuring legal certainty and avoiding double and unintentional non-taxation" (p 10). This is a major innovation whose importance deserves due attention because one of the traditional critic to the M-FTT is that it is not doable for technical reasons. Not only is the electronic tag efficient against fraud but it is also cost-efficient. Message routing companies such as SWIFT can be mobilised to "tag" electronically each financial transaction. Their messages already include a lot of detailed information such as the identity of the seller and buyer, the name of the intermediaries, the nature of the financial instrument, the countries and currencies involved, and who pays the transaction costs. They are present at every stage of a transaction (from trading to final settlement), which guaranties that all the necessary data for tax collection and to prove that the tax has been paid or not paid, and where it has been paid, will be available with no significant extra costs.

A tax that builds on existing legislation to limit trade offshoring

→ As explained in the blueprint, the use of the EU-VAT legal system is a source for inspiration. The Treaty provides for a broad range of territorial connecting factors triggering the application of the tax. The taxable event is triggered by the payment of the transaction. It follows that the core of the tax collection is through the centralized clearing and settlement agencies and electronic trading platforms. Centralized clearing and settlement agencies do not migrate easily because they require big infrastructures. Nevertheless, there is still the fear that the introduction of a tax will induce trading rooms, electronic platforms or even part of the stock exchanges and other intermediaries to migrate outside the reach of collecting and taxing states as described in the blueprint. In fact, taxing states are not powerless to enforce their legislation and to minimize the danger of migration of trading activities. For instance, we think possible to rely on existing legislation in the European Union and if necessary to use it as a starting point to establish a multilateral legal system. For instance, the "Directive on Financial Instruments Markets", (also known as the "Investment Services Directive"), which rules the electronic trading platforms and the "Electronic Commerce Directive" which rules all transactions on goods and services realized through Internet.

- The "Directive on Financial Instruments Markets" is in line with the "Securities and Futures Authority" in the UK which has ruled since 1996 that "advising, arranging, dealing or managing foreign exchange or other transactions" constitutes an "investment business". It means that EBS, Reuter, and other trading platforms are legally considered as "investment firms" and have to be registered in the UK or in any of the EU countries to have the right to sell services to British or other European customers. Practically, it means that if any electronic trading platform wants to do business in the EU, it has to be registered at least in one EU member country. If the registration implies accepting and respecting the tax laws, it means that this electronic trading platform has to declare any financial transactions subject to taxation. I underline that this is true whatever the geographical location of these platforms' headquarters or trading web sites. Practically, it means that either each financial transaction can be taxed at the deal site or the electronic platform has to inform the fiscal authorities of any taxable events which can be taxed at the settlement site. Otherwise, the electronic platform loses the right to do business in the EU.

- The "Electronic Commerce Directive"adds some new principles. The directive defines the place of establishment as the place where an operator actually pursues an economic activity through a fixed establishment irrespective of where websites or servers are situated or where the operator may have a mail-box. Such definition will remove any legal uncertainty and ensure that operators cannot evade supervision, as they will be subject to supervision in the member state where they are established. Services Providers are obliged "to make available to customers and competent authorities in an easily and accessible and permanent form basic information concerning their activities (name, address, e-mail address, trade register number, professional authorisation and membership of professional bodies where applicable, Value Added Tax number)". I think that this gives a legal basis to oblige any financial intermediaries involved in the financial transaction chain to cooperate with the fiscal authorities. The fact that there is a reference to the VAT confirms its interest to use it as a base for establishing the legal base of the M-FTT. The M-FTT will not be the mere copy of the European legal system, but at least it gives some insight on what already exists and what is conceivable.

2. Special topics

A treaty which can be revised and improved

The treaty should not be adopted on a temporary basis, but should be subject to revision with the objective of improving it. This is one option of the blueprint which states that “The Treaty could be subject to revision after a trial period”. If we include in the text that it is possible to cancel the treaty after a trial period, it means that we are not sure that it is a good idea. It is therefore difficult to convince other governments to do it and it puts the permanence of the treaty at risk. It will not convince markets and investors either to respect the treaty and start paying the tax because they can bet on the fact that the treaty may be cancelled after a short trial period. On the contrary, the revision process means that the Treaty is here to stay but that possible problems can find a solution.

The definition of the taxable event

The event that triggers taxation is fundamentally the payment of a transaction. Hence the fact that the collection of the tax will mainly realized at the clearing and settlement stage. But the blueprint rightly states that “entering into a taxable transaction” is the start of a taxable event. This is especially important because many financial transactions are not effectively paid because of netting. The essence of netting is the cancelation of payments between two counterparties which have made equivalent transactions in opposite ways to avoid the cost of settlement and final payment. Netting can reduce up to 50 or 90 percent of the bulk of transactions in clearing and settlement institutions. The stakes are high. Technically, it is perfectly possible to identify one by one each transaction before they are netted. But the final draft of the treaty must be clear in the definition of the taxable event so that legally, each transaction can be taxed before it is netted.

Features of a practical and effective M-FTT

Rodney Schmidt, Phd

In my opinion, it is possible, and not very difficult, to design a Financial Transaction Tax that is practical and feasible, meaning that evasion will be minimal, and that is effective, meaning that it will raise a substantial amount of revenue without unduly disrupting financial markets.

A practical and effective FTT will have a number of core features. It will:

- have broad coverage, especially within an asset class;
- be largely centrally collected, by clearing and settlement agencies and by electronic trading platforms;
- have a low tax rate relative to underlying transaction costs; and
- be assessed on market rather than notional values of derivatives.

A practical and effective FTT does not need to cover all asset classes, and does not need to be implemented by all countries or even all major financial centres. For example, London currently successfully unilaterally collects a Stamp Duty on only equities traded on exchanges.

The ultimate burden (incidence) of the FTT will be borne mostly by large dealer banks and hedge funds.

Coverage

It is possible to levy an FTT on a single asset class, as shown by the London Stamp Duty on equity trading. Nevertheless, to minimize economic distortions through asset substitution, it is prudent to tax a broad range of assets, including equities, commodities, derivatives, bonds, money market instruments, and foreign exchange. This also makes it easier to collect the tax, since it is no longer necessary to distinguish between these instruments. For example, it is more difficult, though still possible, to tax only foreign exchange transactions, than to tax both foreign exchange and domestic currency (money market) transactions, when both are settled in domestic Large-Value Payments Systems.

Within an asset class, such as equities, it is important to tax all transactions by all types of traders. It is easy for traders to exploit exemptions by adjusting trading strategies and disguising trading intentions. Concerns to minimize the tax burden on retail traders and for trades directly related to real economy transactions are more effectively addressed through tax collection mechanisms and the tax rate.

Closely related asset classes should all be taxed. For example, both equities and derivatives instruments should be taxed, because they are close substitutes. A given financial position can be taken by trading either equities or derivatives, or both. See below for more on taxing derivatives.

Collection

The most effective and comprehensive way to collect an FTT is through, and by, the centralized clearing and settlement agencies and electronic trading platforms. These agencies and platforms appear in all financial markets, both on-exchange and off-exchange (over-the-counter (OTC)), and are the foundation for modern trading in financial instruments.

In most cases, such as on exchanges, a single agency, the central counterparty, clears and settles all trades occurring in that market. Sometimes a single agency settles all trades occurring on multiple exchanges. In major OTC markets, such as foreign exchange and most derivatives, it is also the case that a single agency settles most trades. In foreign exchange this agency is CLS Bank; in derivatives it is MarkitSERV.

However, in some markets, trades may be settled by more than one agency. For example, in foreign exchange, trading may be settled either in CLS Bank or in domestic Large-Value Payments Systems. Thus, the FTT has to be collected in both systems. Coordinating this is not a problem, since a single transaction will only pass through one of these systems.

Sometimes trading occurs on unofficial 'exchanges', electronic trading platforms, provided by large dealer-broker banks. These platforms also serve as unofficial settlement agencies, because the host dealer-broker banks net out the vast majority (up to 95 percent) of the trades against each other before sending the remaining payment obligations on to a settlement agency. In this case, the host dealer-broker bank would collect the FTT on trading on the platform. Only a few banks are large enough to host such platforms, so it is feasible to enforce tax collection through verification of records.

Trades of financial instruments are nearly always settled in one agency. That is, they are largely mutually exclusive, so that a single transaction will not normally pass through more than one of them. The potential to tax a transaction more than once is therefore not a problem in practice.

In principle, it is possible to evade a tax on equities collected at an exchange by shifting trading to an exchange outside of the tax jurisdiction. (This is not possible in the case of foreign exchange and some derivatives, since settlement is globally centralized.) However, such trade-shifting can be avoided by designing the tax appropriately, as shown by the London Stamp Duty. Specifically, the tax should be associated with legal payment finality. That is, unless the tax is paid on the transaction, payment to settle a trade does not have official, legal, recognition or protection.

Centralized clearing and settlement agencies and electronic trading platforms constitute the fundamental infrastructure of interbank (perhaps now a more accurate term would be 'wholesale') financial markets. Most retail trading in financial assets uses a different infrastructure, namely, local retail banks. Thus, using clearing and settlement agencies and electronic trading platforms as FTT collection points implies that the tax would not, in fact, be collected on most retail financial transactions, those most directly related to real economic activity.

Tax rate

→ The FTT is, in effect, a transaction cost, similar to other transaction costs, such as broker fees and commissions and other trading and settlement costs. As in any market, there is a relationship between transaction costs and trading volumes – the higher the costs, the lower the volumes. The FTT raises transaction costs in financial markets, and will therefore reduce trading.

The FTT should be set at a rate that raises significant revenues without reducing trading too much.

Given a proposed tax rate, we can estimate the ensuing reduction in trading volume based on the normal response of trading to underlying (pre-tax) transaction costs. The key factor in such an estimation is the magnitude of the tax rate relative to underlying transaction costs. That is, the key is the percentage increase in transaction costs due to the tax.

Underlying transaction costs are different across financial asset markets. For example, they are significantly smaller in foreign exchange markets than in bond markets. This is because of differences in the size and organization of financial markets. As another example, transaction costs in equity trading organized as an auction market (such as the New York Stock Exchange) are generally smaller than in equity trading organized as a dealer market (such as the NASDAQ).

To avoid distortions and differential impacts across financial markets, the FTT should be set at a rate that is constant relative to (differing) underlying transaction costs. For example, it could be set at a rate of a third or half of underlying transaction costs in all markets. Then the absolute tax rate would be different across asset markets. Thus, for example, the most commonly proposed tax rates are 0,005% for foreign exchange markets and 0,05% for equity markets.

The absolute burden of the tax on a trader in a given period depends, of course, on how much, and how often, the trader trades. Transaction costs in large markets are very low because trading volumes are so high. Trading volumes in interbank (wholesale) markets, dominated as they are by high-frequency traders, are orders of magnitude higher than in retail markets. So, again, the burden of the tax will fall most on traders in interbank markets.

Market values of derivatives

→ Some financial assets are more complex than others. On one hand, buying foreign exchange spot entails a one-time payment of cash. On the other hand, buying a derivative entails making or receiving a payment later, depending on intervening movements in price or value of an underlying asset. Taxing spot foreign exchange is straightforward. However, in the case of a derivative, does one only tax the purchase price of the instrument (if there is one) and the subsequent payment or receipt specified in the contract, or does one also tax the 'notional' value of the contract, the value of the underlying asset on which the stream of payments is based?

This is not a question of feasibility, but of potential distortions caused by the tax. If the intention is to minimize substitution in trading between derivatives and their underlying assets because of the tax, then one should tax notional values of derivatives, since this is the equivalent basis for taxing trades in the underlying assets.

However, transaction costs in derivative markets, relative to the notional value of derivatives, are already a fraction of costs in the underlying asset markets, and yet both markets co-exist. This is so in part because derivatives depend for their valuation on well-functioning markets for the underlying assets. Therefore, if the intention is to maintain current market structures, one should not tax notional values of derivative contracts.

Incidence of the FTT

→ Large dealer banks and hedge funds account for the vast majority of financial transactions, using computerized, high-frequency trading strategies. Because most financial markets, especially those dominated by high-frequency trading, are highly competitive and speculative, there is limited opportunity for dealers and hedge funds to pass on the cost of the tax to other, smaller, traders. That is, dealers and hedge funds compete heavily to trade with smaller counterparties, both to gain market share and to obtain market information on which to speculate subsequently. Therefore, ultimately dealers and hedge funds will likely bear most of the burden of the tax.

The introduction of a FTT – some considerations from a legal perspective

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The introduction of a FTT at a multilateral level is an ambitious, yet not utopian exercise. Opponents to the tax do not only refer to policy arguments on the desirability of taxing the financial industry, but often also invoke various (legal) obstacles to the introduction of a tax or raise doubts as to the feasibility of levying or enforcing a FTT at an international scale. To a large extent, these objections can be overcome. From a legal perspective, creating a multilateral FTT constitute a big challenge, as the FTT should be designed as a comprehensive, effective and cost-efficient system, while minimizing the opportunities for tax avoidance, regulatory arbitrage or free-riding. The effectiveness of an FTT in a globalized economic environment that offers large opportunities for moving taxable transactions internationally or off-shore at a low cost, requires to explore the limits of territoriality in imposing and enforcing a FTT. Furthermore, the feasibility of a FTT will largely depend from the possibility to collect and enforce the tax at a low cost, in view of the peculiar nature of the FTT as a low-rate tax on a large volume of individually taxed transactions. This operational requirement should be appropriately translated into the legal system.

The FTT and free movement of capital

The introduction of an FTT could face legal objections as it restricts the free flow of capital (either domestically or on a cross-border) by making the acquisition or disposal of financial instruments more costly. Notably in the European Union (EU), where free movement of capital constitutes a fundamental and legally binding economic freedom, both within the EU or in relation to non EU-countries, the FTT could be regarded as a prohibited restriction to free movement of capital. There are, however, convincing arguments to maintain a FTT under the EU rules: although a FTT comes at a cost, the rates currently proposed are only marginal relative to the transaction value. Moreover, provided the tax is applied in a non-discriminatory manner, for both domestic and cross-border transactions, it does not, in our view, violate EU law as currently interpreted by the Court of Justice of the EU.

Scope of application of the FTT

There is no reason why a FTT could not be introduced on a broad basis, encompassing to the largest extent all financial instruments, including derivatives, and currencies. If a FTT is to generate a pre-determined financial revenue, often with the purpose of funding development aid, broadening the scope of financial assets to which it applies allows to keep tax rates relatively lower. Eventually, policy makers will have to draw the line regarding the scope of application of the FTT. The effectiveness of the tax however commands that comparable or substitutable financial instruments be subject to taxation; if not, the FTT could generate tax driven incentives to move into non-taxed substitute investments. Furthermore, if the FTT is commonly designed as a tax on ‘financial’ transactions, it should be borne in mind that financial transactions are not per se speculative or aimed at financial gains. In practice, however, it will often prove extremely complex to distinguish between both, on the basis of objective criteria. For instance, entering into a derivative contract may serve hedging purposes, and thus be devised to mitigate risks. Taken in isolation, it is not possible, however, to distinguish such a transaction from a purely speculative one. Although levying the FTT will increase the cost of the hedge, we can assume that, due to the low rate, it will not have a major impact on investors’ behaviour.

The FTT is essentially targeted at secondary market transactions. Primary market operations (share and bond issues etc.) should be exempted, as imposing a FTT would directly impair on the cost of funding for enterprises put market operations at a competitive disadvantage compared to other sources of funding.

Some further refinements regarding the scope of application and possible exemptions could be considered, having regard to other legitimate interests or market imperatives, or to avoid multiple taxation of a single transaction. For instance, exempting central banks from the FTT when effecting market operations in the performance of monetary policy functions, appears legitimate. Public debt agencies could be exempted from FTT for financial transactions related to government debt management. For centrally cleared transactions that involve the interposition of a central counterparty (CCP), a mitigation of the tax rate has been proposed in order not to put at a disadvantage centrally cleared operations in comparison with other types of transactions (eg internalization of trades). Considering the peculiar position of a CCP in the transaction chain, the FTT system should make sure that the tax burden is always borne by the counterparty of the CCP. With a view to ensuring a uniform application of the FTT in all participating countries, exemptions are best included in the treaty establishing the FTT.

Territorial reach

➔ The treaty takes a broad view on its territorial application, thereby forming a strong barrier against delocalization and international tax avoidance. The treaty is not novel in this regard. Other international tax rules take a broad view in territorial reach of the tax (enforcement) system as well (eg the EU savings directive, the US regime of Qualified intermediaries or, more recently, the upcoming FATCA regime). Laying down a cascade of connecting factors for the application of the FTT diminishes the effectiveness of opting-out of the FTT system for the major international financial centers. The mere circumstance that trade is settled in a non-participating will not suffice to immunize transactions from the FTT. As soon as one of the parties to a transaction or a financial intermediary involved in the transaction chain is located in a participating state, the FTT will be levied. Moreover, in the situations where the tax collection cannot be realized through the clearing and settlement institutions, financial intermediaries will bear higher administrative burdens a the level of tax collection. This, in turn, could provide incentives for directing trade to markets in participating states, where tax collection can be centralized through the clearing and settlement institutions.
The territorial reach of the FTT obviously has limits. When there is no relevant territorial connecting factor in the transaction chain with a participating state, no FTT can be imposed. The mere circumstance that only the issuer of the financial instruments (or of the underlying for derivatives) is established in a participating state may not lead to a situation where the issuer ultimately bears the cost of the FTT.

Taxable event and tax collection

➔ In view of the increasing centralization of post-trade in financial instruments and derivatives, induced by various regulatory initiatives in major financial centers (eg EMIR in the EU), the principle to collect the FTT at the level of the clearing and settlement institutions is likely to produce substantial efficiency gains, as compared to a collection at the level of the financial intermediaries or end-investors. Furthermore, the FTT will necessarily require the adaptation of IT-systems, in particular if an electronic tagging system is introduced, that can best be implemented at the level of the centralized clearing process. It should be stressed that the taxable base for the FTT will be the gross transactions before they enter into the clearing system, where mutual payments and deliveries usually are settled on a net basis. In essence, the proposed FTT system presents characteristics of an accrual system, although it situates the taxable event at the moment of settlement.

The identification of a taxable event could raise interpretation issues as to know when a transaction is concluded or entered into. Deliberately, the FTT treaty does not attempt to mould the conclusion of a transaction into a legal definition. A more functional approach could be adopted in this regard, taking the ‘irrevocability’ of a financial transaction as the relevant criterion for identifying a taxable event. The irrevocable character could follow from statutory rules (eg the Settlement Finality Directive in the EU), from market regulations or contractual provisions for OTC transactions.

Specific attention should be paid to the sanctions regime. As the FTT is a low-rate tax, the sanction should have a sufficient deterrent effect, while keeping enforcement costs for tax authorities low. The centralization of tax collection in the hands of the clearing and settlement organizations, combined with existing record-keeping obligations in the markets will generally provide sufficient data for tax authorities to supervise the cast majority of plain vanilla transactions. Linking the payment (or FTT-tagging) of a transaction to the eligibility for clearing and settlement should sufficiently incentivise market participants to comply with the FTT requirements. In other words, the unenforceability of the transaction as a sanction for non-compliance with the FTT is still applied within a limited time frame, thus avoiding a disruptive effect on normal market operations. Unenforceability of the transaction would be more disruptive, however, if the collecting agent would subsequently fail to transmit the collected FTT to the tax authorities. Pecuniary penalties could In this regard also serve as a sufficient deterrent to non-compliance with the FTT obligations.