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OPINION OF THE LEGAL SERVICE¹

Subject: Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (FTT)
- compatibility with the Treaty provisions of the inclusion of spot currency transactions within the scope of the proposal

I. INTRODUCTION

1. The proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (FTT)² ("the proposal") was submitted by the Commission to the Council on 14 February 2013, in accordance with Council Decision 2013/52/EU of 22 January 2013 authorising enhanced cooperation in the area of financial transaction tax (FTT)³.

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² ST 6442/13, COM(2013) 71 final of 14.02.2013.

³ OJ L 22, 25.1.2013, p. 11.

In the course of the proceedings of the Working Party on Tax Questions - Indirect Taxation, the Council Legal Service was asked whether the inclusion of spot currency transactions within the scope of the proposal would be compatible with the Treaty provisions. The present opinion aims at answering that question.

II. LEGAL BACKGROUND

2. The relevant provisions of the proposal are the following:

"Article 2 Definitions

1. *For the purposes of this Directive, the following definitions shall apply:*

(....)

(2) *'Financial transaction' means any of the following:*

- a) *the purchase and sale of a financial instrument before netting or settlement;*
- b) *the transfer between entities of a group of the right to dispose of a financial instrument as owner and any equivalent operation implying the transfer of the risk associated with the financial instrument, in cases not subject to point (a);*
- c) *the conclusion of derivatives contracts before netting or settlement;*
- d) *an exchange of financial instruments;*
- e) *a repurchase agreement, a reverse repurchase agreement, a securities lending and borrowing agreement;*

(3) *'Financial instruments' means financial instruments as defined [in] Section C of Annex I to Directive 2004/39/EC of the European Parliament and of the Council⁴, and structured products;*

(4) *'Derivatives contract' means a financial instrument as defined in points (4) to (10) of Section C of Annex I to Directive 2004/39/EC, as implemented by Articles 38 and 39 of Commission Regulation (EC) No 1287/2006⁵; (...)"*

⁴ OJ L 145, 30.4.2004, p. 1.

⁵ OJ L 241, 2.9.2006, p. 1.

*"Article 3
Scope*

1. This Directive shall apply to all financial transactions, on the condition that at least one party to the transaction is established in the territory of a participating Member State and that a financial institution established in the territory of a participating Member State is party to the transaction, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction.

(...)"

3. Section C of Annex I to Directive 2004/39/EC ("MIFID") reads:

"Section C

Financial Instruments

(1) Transferable securities;

(2) Money-market instruments;

(3) Units in collective investment undertakings;

(4) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;

(5) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);

(6) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF;

(7) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;

(8) Derivative instruments for the transfer of credit risk;

(9) Financial contracts for differences.

(10) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls."

III. LEGAL ANALYSIS

A. Scope of the proposal

4. According to Article 3 (1) of the proposal, its scope covers "*all financial transactions*"⁶. According to Article 2 (1), points (2) and (3) thereof, the term "*financial transactions*" covers transactions on financial instruments as defined in Section C of Annex I to MIFID. That definition of financial instruments includes derivative contracts relating to currencies. However, under the same definition, spot currency transactions are not listed amongst the financial instruments. Therefore, according to the proposal, spot currency transactions are not subject to the financial transaction tax⁷.

⁶ With the exception of certain entities and certain transactions as foreseen in paragraphs (2) and (4) of Article 3 of the proposal that are of no relevance for the present legal analysis.

⁷ According to point 3.3.2 of the explanatory memorandum of the proposal, "*[i]t emerges from the definitions used that spot currency transactions are not taxable financial transactions, while currency derivatives contracts are*".

5. The exclusion of spot currency transactions from the scope of the proposal does not merely result from the reference to MIFID provisions, but was a deliberate choice by the Commission justified by the need to preserve the free movement of capital⁸. The impact assessment accompanying the proposal specifies that "*[a]dding certain products, notably spot currency transactions, has also been raised and discussed as an option in the Working Party of the Council. However, as according to the Commission such a spot currency transaction is not a transaction in a financial instrument but simply a capital movement (like a payment) and as taxing this capital movement would not comply with Article 63 TFEU, this option is discarded.*"⁹

B. Compatibility with Treaty provisions of the inclusion of spot currency transactions

6. Within the above described context, it should be examined whether amending the proposal in order to include spot currency transactions within its scope would be compatible with the Treaty provisions.

a) Free movement of capital

7. At the outset, the Legal Service wishes to comment on the Commission's analysis according to which enlarging the scope of the proposal to spot currency transactions would amount to taxing a capital movement and would accordingly not respect the principle of the free movement of capital.

⁸ See explanatory memorandum p. 9.

⁹ See ST 6442/13 ADD 1 (SWD(2013) 29 final), p. 26, footnote 35. For more extensive explanations, see impact assessment accompanying the Commission's proposal of 28.09.2011, ST 14942/11 (SEC(2011) 1102 final), ADD 8, p. 14, Box (5), "*Legal issues with a CTT*".

8. First, that analysis focuses on spot currency transactions within the context of underlying transactions, such as the purchase of goods or services (current payments), and overlooks the case of spot currency transactions that are not linked to any underlying transaction¹⁰. Arguably, the taxation of spot currency transactions ancillary to underlying operations could be regarded as materially restricting the exercise of Treaty-based fundamental freedoms. However, the fact remains that spot currency transactions can take place on an autonomous basis, unrelated to the performance of any underlying economic activity¹¹. Therefore, the Legal Service is of the view that the taxation of spot currency transactions cannot be considered *in abstracto* as an unjustified restriction to the free movement of capital.
9. Second, the distinction made by the Commission between "*capital movement*" and "*transaction in a financial instrument*" in the above mentioned impact assessment is not supported by Union legislation and settled case law. While the Treaty provisions do not define the term "*movement of capital*", the Court¹² refers to the indicative nomenclature contained in Annex I to Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the EEC Treaty¹³, which brought about the full liberalization of capital movements and which enumerates several types of financial instruments falling within the scope of the movement of capital. From this point of view, there would be no difference, in terms of the assessment of their compatibility with the free movement of capital, between taxing financial instruments and taxing spot currency transactions.

¹⁰ For a distinction between current payments and movement of capital, see judgment of 31 January 1984 in Joined Cases 286/82 and 26/83, *Luisi and Carbone*, ECR p. 00377, paragraph 21; judgment of 14 December 1995 in Joined Cases C-163/94, C-165/94 and C-250/94, *Sanz de Lera*, ECR p. I-04821, paragraph 17.

¹¹ In practical terms, it would be difficult to separate the two kinds of spot currency transactions for the purpose of distinguishing whether they are or not subject to the financial transaction tax.

¹² See judgments of the Court of 4 June 2002 in Case C-367/98, *Commission/ Portugal*, ECR p. I-04731, paragraph 37; of 13 May 2003 in Case C-98/01, *Commission/UK*, ECR p. I-04641, paragraph 39; of 23 February 1995 in Joined cases C-358/93 and C-416/93, *Aldo Bordessa*, ECR p. I-00361, paragraph 17; of 6 June 2000 in Case C-36/98, *Verkooijen*, ECR p. I-04071, paragraphs 27-28; of 16 March 1999 in Case C-222/97, *Trummer and Mayer*, ECR p. I-01661, paragraphs 20-21.

¹³ OJ 1988 L178, 8.7.1988, p. 5.

10. Last but not least, in principle, harmonisation measures that apply equally to all Member States, that intend to approximate previously disparate national rules and that, as such, are genuinely addressed at the establishment of the internal market, cannot be considered as incompatible with the Treaty fundamental freedoms referred to in Article 26(2) of the Treaty on the Functioning of the European Union (TFEU)¹⁴.
11. It flows from the above considerations that expanding the scope of the proposal to include spot currency transactions would not necessarily violate the free movement of capital.
12. However, it should be pointed out that the taxation of spot currency transactions cannot be regarded *per se* as a way to attain the objectives pursued by the proposal, that target the markets of financial instruments.

b) Council's power of amendment

13. Assuming that it were envisaged to amend the proposal in order to include spot currency transactions in its scope, the question should be raised whether that falls within the amendment powers which are available to the Council.

¹⁴ See judgements of 13 November 1990 in Case C-331/88, *Fedesa*, ECR 1990 p. I-04023, paragraphs 19 and 20; of 5 October 1997 in Case C-5/77, *Denkavit*, ECR 1977 p. 01555, paragraph 35; of 30 November 1983 in Case C-227/82, *Leendert van Bennekom*, ECR 1983, p. 03883, paragraph 35; of 29 February 1984 in Case C-37/83, *Rewe-Zentral AG*, ECR 1984, p. 01229, paragraph 19. It should be nevertheless mentioned for the sake of completeness that, in the absence of full harmonisation, national measures adopted in line with Union harmonisation legislation (such as exemptions, temporary derogations, harmonisation in stages) must be compatible with the Treaty fundamental freedoms, see C-5/77 above, paragraph 34; C-227/82 above, paragraph 35; C-37/83 above, paragraph 20; judgment of 26 October 2010 in Case C-97/09, *Schmelz*, ECR 2010 p. I-10465, paragraphs 50-54; of 16 December 2008 in Case C-127/07, *Arcelor Atlantique et Lorraine*, ECR 2008 p. I-09895, paragraph 57 and case law cited.

14. Pursuant to Article 20(1) of the Treaty on European Union (TEU), "*Member States which wish to establish enhanced cooperation between themselves within the framework of the Union's non-exclusive competences may make use of its institutions and exercise those competences by applying the relevant provisions of the Treaties, subject to the limits and in accordance with the detailed arrangements laid down in this Article and in Articles 326 to 334 of the Treaty on the Functioning of the European Union.*" (emphasis added) Accordingly, the role of the institutions and the procedures laid down by the Treaties must be respected within the framework of the Treaty provisions on enhanced cooperation.
15. Regarding the possibility for the Council to amend the Commission's proposal, Article 293(1) TFEU provides that "*[w]here, pursuant to the Treaties, the Council acts on a proposal from the Commission, it may amend that proposal only by acting unanimously (...)*"¹⁵. Consequently, whenever the Council intends to amend a proposal against the intention of the Commission, unanimity is required.
16. However, in the light of settled case law, the power of the legislator to amend Commission's proposals, even if the Council acts by unanimity pursuant to Article 293(1) TFEU, is not unlimited. The Court has held that the amendments to a proposal must remain within the scope determined by the Commission. According to the Court, this is the case when the amended act does not alter the nature of the proposal, determined by the subject-matter and the objectives thereof ¹⁶. It is against that yardstick that the inclusion of spot currency transactions in the scope of the proposal needs to be measured.

¹⁵ The unanimity required would be that of the Participating Member States only, pursuant to Article 330, second paragraph TFEU.

¹⁶ See in this respect judgments of 11 November 1997 in Case C-408/95, *Eurotunnel*, ECR p. I-06315, paragraphs 35 to 39 and of 30 May 1989 in Case 355/87, *Commission/ Council*, ECR p. 01517, paragraphs 42 to 44. See also Legal Service opinions of 19 September 2002 (ST 12151/02), of 30 October 2003 (ST 14181/03), of 26 April 2004 (ST 8748/04) and of 4 February 2009 (ST 6096/09).

17. Regarding the subject-matter of the proposal, as described above, it relates to financial transactions with respect to financial instruments as defined by Union legislation. In this respect, the inclusion of spot currency transactions in the scope of the proposal would substantively alter the subject-matter thereof: the financial transaction tax would not be "financial" anymore, but it would expand to a wide range of transactions that are not related to financial markets.
18. As for the objectives thereof, the proposal refers mainly to the following¹⁷:
- to ensure the proper functioning of the internal market for transactions in financial instruments and to avoid distortion of competition between financial instruments;
 - to ensure that financial institutions make a fair and substantial contribution to covering the costs of the recent crisis; and
 - to create appropriate disincentives for transactions that do not enhance the efficiency of financial markets thereby complementing regulatory measures to avoid future crises.
19. Through the prism of the above objectives, it is quite straightforward that taxation of spot currency transactions is neither relevant nor appropriate for the attainment thereof. Regarding the first stated objective, as described above, spot currency transactions are not transactions in financial instruments. Regarding the second stated objective, spot currency transactions mainly concern the day-to-day transactions of the real economy that are not related to the recent financial crisis. Last, regarding the third stated objective, spot currency transactions are not carried out in the financial markets as regulated by Union legislation. Consequently, an expansion of the scope of the proposal to spot currency transactions would substantively alter its objectives.

¹⁷ See Recital (1) and explanatory memorandum, pages 2 and 4.

20. Such an alteration of the proposal's subject-matter and objectives, even if adopted by unanimity (which is in any event the voting rule imposed by the relevant legal basis), would violate the Commission's right of initiative as it would not remain within the scope of the proposal; accordingly it would go beyond the Council's power of amendment, as determined by the Court.

IV. CONCLUSION

21. For the reasons set out above, the Legal Service is of the opinion that the inclusion of spot currency transactions within the scope of the proposal:
- a) would not necessarily be incompatible with the free movement of capital;
 - b) would exceed the Council's power of amendment of the proposal.
