

**Deutsches Aktieninstitut's position on  
Draft Council Directive for implementing  
enhanced cooperation in the area of  
financial transaction tax**

Financial transaction tax will severely burden the  
real economy and retail investors

## Summary

As has frequently been expressed over the past years Deutsches Aktieninstitut rejects the financial transaction tax as it will harm the functioning of securities and especially derivative markets, significantly raise the costs of finance for non-financial companies and seriously harm the risk management with derivatives. Furthermore, it will reduce the yields of pension schemes in a negative way.

An analysis performed by Deutsches Aktieninstitut among 24 member companies reveals that the total tax burden will likely sum up to EUR 1.5 bn. p.a. This assessment does not include other negative impacts, e.g. higher transaction costs due to decreased market liquidity, and is therefore a very conservative estimate. Also, the FTT will devalue the special treatment of derivatives used for risk-mitigating purposes under EMIR and CRD IV/CRR. Furthermore, the FTT restricts the capability and attractiveness of Germany as a financial centre.

This position paper is an extract from a longer position paper on the FTT in German language.<sup>1</sup> It is supported by the Verband Deutscher Treasurer (Association of German Treasurers) without restrictions.

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1 Deutsches Aktieninstitut, Zum Vorschlag der EU-Kommission für eine Richtlinie des Rates über die Umsetzung einer Verstärkten Zusammenarbeit im Bereich der Finanztransaktionssteuer, 2 May 2013

## 1 Introduction

Last year eleven Member States decided to introduce a financial transaction tax (FTT) within the framework of enhanced cooperation and asked the European Commission for a proposal.

The proposal of the European Commission from February 2013 follows in particular a fiscal target as it aims at a "fair and substantial contribution of [financial institutions] to covering the costs of the recent crisis". In addition, the FTT shall provide "disincentives for transactions which do not enhance the efficiency of financial markets" with an explicit focus on high frequency trading. The European Commission and other political decision makers claim to exclude non-financial companies and retail investors from the FTT. For example, the German federal government expressed its intent to assess the impact of the FTT on pension schemes, retail investors and the real economy and to avoid negative consequences in June 2012.

However, this exclusion of non-financial companies and retail investors is not consistently implemented, since it is based on the unrealistic assumption that the tax burden will not be passed on by the financial sector to the end users. In reality non-financial companies will not only have to carry a huge cost burden but will also be affected negatively in other respects.

This position paper has the following structure:

- Section 2 describes the impact of the FTT on the real economy;
- The quantification of this impact on 24 member companies of Deutsches Aktieninstitut is explained in section 3;
- Other effects of the financial transaction tax on the real economy, which were not included in the impact study are the subject of section 4;
- Section 5 discusses further shortcomings of the concept, for example the revenue forecasts and negative effects on retail investors.

## 2 Real economy has to bear a large share of the tax burden

Although the scope of the FTT is limited to financial institutions non-financial companies have to bear a large part of the tax burden as the costs of the tax will be passed on to the non-financial end users. This situation will be exacerbated by cascade effects which are likely to multiply the tax-rates of the FTT because the proposal does not provide for pre tax allowances. Furthermore, the extensive definition of financial institution will likely comprise many non-financial companies including medium-sized enterprises and, thus, trigger a direct tax liability of non-financial companies. Overall, the FTT undermines justified exemptions provided by the legislator in other regulations, e.g. in the European Market Infrastructure Regulation (EMIR) and the Capital Requirements Directive / Regulation (CRD IV / CRR) and decreases the returns occupational pension schemes.

### 2.1 A variety of instruments used by the real economy is negatively affected

Despite the claim not to deteriorate financing capabilities of non-financial end users a variety of financial instruments used by the real economy in its corporate financing and risk management is negatively affected by the FTT:

- **Risk-mitigating derivatives:** derivatives to mitigate risks referring to exchange rate, commodity price or interest rate fluctuations will become significantly more costly or not be available anymore. A FTT levied on these risk-mitigating instruments would contradict existing exemptions in particular in the European Market Infrastructure Regulation (EMIR) and the Capital requirements Directive / Regulation (CRD IV / CRR). Non-financial companies are excluded under EMIR from the clearing obligation and from the duty for bilateral collateralisation if the respective derivatives have predominantly for risk-mitigating purposes in order not to overstretch non-financial companies liquidity reserves. The EMIR exemptions explicitly acknowledge the importance of hedging instruments which are closely linked to the non-financial operative business. Consequently, a similar exemption has been introduced in CRD IV/CRR for capital requirements regarding to risks stemming from credit-valuation-adjustments.

- **Pension schemes:** The FTT negatively affects corporate pension schemes which become more and more important as additional old age provisions. They will be hit both by the taxing of securities transactions (such as the selling and buying of shares and bonds) and derivative transactions which are used by pension schemes for risk-mitigating purposes. In addition, pension schemes are directly liable to pay the tax according to the definition in art. 2 para. 2 no. 8 lit. f (“pension fund or an institution for occupational retirement provision”). Beyond this definition due to art. 2 para 2 no. 8 lit. j further pension schemes like contractual trust arrangements (CTA) or “Unterstützungskassen” are directly liable to pay the tax (please refer to section 2.4 of this position paper).
- **Other transactions (examples):** The investment of cash reserves in financial instruments like money market funds and repos, M&A transactions by the way of share purchases or share buybacks which are relevant as part of the capital structure management. Furthermore, negatively impacted is the issue of commercial papers or asset backed securities as these instruments are not covered by the primary market exemption according to art. para. 4 lit. a.

## 2.2 Tax burden will be passed on to the non-financial end users

Although non-financial companies are exempted the FTT will affect the real economy in several ways. In general, the financial sector will pass on a large part of the FTT-burden to their non-financial end users. This assumption is also shared by the International Monetary Fund, which therefore rejected the introduction of a FTT: “Its real burden may fall largely on final consumers rather than, as often seems to be supposed, earnings in the financial sector.”<sup>2</sup> It is worth to note that the European Commission comes to the same conclusion in its impact study from 2011: “A large part of the burden would fall on direct and indirect owners of traded financial instruments.”<sup>3</sup>

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2 IMF: A fair and substantial contribution by the financial sector. Final report for the G-20, Washington 2010, p. 20.

3 European Commission: Commission Staff Working Paper, Executive Summary of the Impact Assessment, Brussels 2011, p. 11.

### 2.3 Cascade effects in stock market trading and OTC derivatives transactions lead to costs well above the nominal tax rate

The FTT proposed by the European Commission is usually associated with cascade effects as one financial transaction often triggers additional transactions and thus more tax events. The burden of these cascade effects, which are ultimately borne by the end user as well, will exacerbate the costs for the real economy described above.

Cascade effects occur e.g. when securities are traded on the stock exchange where a number of market participants intermediate between the ultimate seller and the ultimate buyer (in particular the transaction between the bank and the end user and the transaction between the bank, acting as clearing member, and the central counterparty). That's also true for OTC-derivatives as the bank will minimize the risk related to the derivative concluded with the non-financial end user with other derivatives which are concluded with other banks. Therefore, the derivative with the end user triggers further derivative transactions which are in turn also taxable.

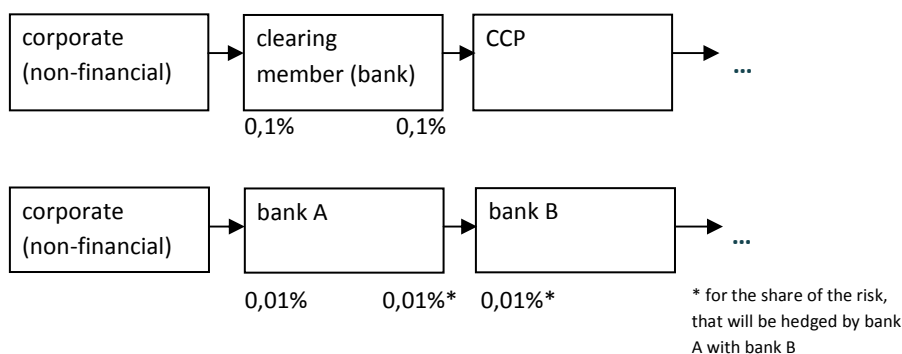


Chart 1: Cascade effects of a typical purchase of a security (above) and OTC derivative transaction (below)

### 2.4 Definition of "financial institution" includes large parts of the real economy

The definition "financial institution" in art. 2 para. 1 no. 8 lit. j is very wide, covers many non-financial companies and triggers direct tax liability for these companies. According to the definition non-financial companies are considered as financial institutions "in case the average annual value of its financial transactions constitutes more than fifty per cent of its overall average net annual turnover as referred to in art. 28 of that the annual average of its financial transactions representing more than fifty percent of its average annual net revenue in accordance with art. 28 of Directive 78/660/EEC."

This wide definition is associated with the following problems:

- **Reference to the single legal entity:** A major problem arising from this definition is its reference to the single legal entity instead of the whole non-financial group. This ignores the fact that many non-financial companies centralise their treasury function – for example entering into derivative contracts, the investment of liquid funds et cetera – in a separate legal entity or in their holding company.

As these treasury units are exclusively responsible for the corporate financing and risk management of the group (and execute holding functions) their operative revenues are negligible (or non-existent). Accordingly, a central treasury unit will usually exceed the 50 percent threshold of the definition of "financial institution" in art. 2 para. 1 no. 8 lit. j and becomes directly liable for the FTT not only for external transactions with their banking counterparties, but also for intra-group transactions, i.e. for transactions between the central treasury unit and the operating companies for which the risk management is performed. Both would result in a tremendous increase of the tax burden for the real economy. Overall, it is not clear why the classification as "financial institution" is crucially influenced by the individual company's organizational structure.

For the same reasons art. 2 para. 1 no. 8 lit. j would also classify those pension schemes as "financial institution" which are not covered by art. 2 para. 1 no. 8 lit. d – e.g. Contractual Trust Arrangements (CTAs) or "Unterstützungskassen".

- **Wide scope of "financial activity":** The definition of "financial activity" is extremely wide which will make the classification as "financial institution" even more likely. For example, it includes activities that are directly related to important operative activities, e.g. risk-mitigating derivatives, strategic M&A-transactions, the issue of financial instruments and guarantees and commitments.
- **Exit-option has to be clarified:** It has to be made clear that the "exit option" in art. 2 para. 3 lit. d which ends the status "financial institution" and the direct tax liability cannot be "requested" but is an inevitable consequence of falling below the thresholds.

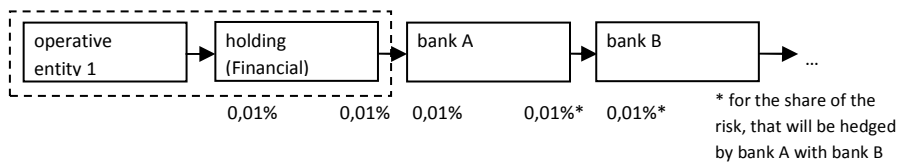


Chart 2: taxation of OTC derivatives – non financial company is regarded as “financial company” in the meaning of the FTS

## 2.5 Incomplete exemption for primary market transactions

According to art. 3 para 4 lit. a primary market transactions are exempted from the FTT. This exemption refers to art. 4 para. 1 no. 18 lit. a and b of Directive 2004/39/EC (MiFID) and comprises shares and bonds only. Money market instruments (e.g. commercial papers) are explicitly defined in art. 4 para. 1 no. 19 of Directive 2004/39/EC and are not covered by the primary market exemption. The same applies to asset backed securities.

Therefore, the issue of commercial papers and asset backed securities would be levied with FTT although these instruments are – like shares and bonds – an important financing instrument for the real economy. This would also contradict art. 5 of Directive 2008/7/EC which prohibits the indirect taxation of capital contributions.

## 2.6 Impact on market maker / designated sponsors

In order to support trading of less liquid securities market makers permanently place bid and ask orders to ensure market liquidity. As liquidity is a prerequisite for investors to buy shares or bonds especially small and medium-sized issuers have to rely on market makers if they access the capital market as a source of funding. Both the purchase and sale of securities by the market makers are “standalone” transactions that are subject to the FTT. As profit margins of market makers are relatively small the FTT will largely or completely erode their earnings. The business of “market making” is therefore in danger of disappearing with the result of decreasing liquidity and increased costs of finance.

Especially for small and medium-sized issuers financing through the capital market would be hardly possible under these circumstances. The FTT, thus, contradicts the aim of the European Commission, expressed in the Green Paper “Long-term financing of the European Economy” recently, to improve access to the capital markets in particular for small and medium-sized companies.



### 3 Quantification of the impact on the real economy

An analysis performed by Deutsches Aktieninstitut among 24 member companies reveals that the total tax burden will likely sum up to EUR 1.5 bn. p.a. Indirect effects like an increase in costs of finance resulting from decreased market liquidity are not included in this estimate.

#### 3.1 Methodology and scenaria

Deutsches Aktieninstitut has quantified the impact of the FTT on companies of the real economy based on the European Commission proposal of 14 February 2013.

For this reason 24 mainly huge German companies have calculated the potential impact of the FTT on the basis of a common methodology that allows for company-specific adjustments. The following transactions of the fiscal year 2012 have been included in the calculation (see above in section 2.1 of this position paper):

- external and internal derivative instruments,
- securities trading of pension vehicles,
- issuance of commercial papers and asset backed securities,
- other financial transactions covered by the FTT (e.g. securities investment of the cash management).

The analysis provides for different scenarios, in order to distinguish between the effects of different elements of the European Commission's proposal.

First, it distinguishes between direct effects of the FTT and the unavoidable indirect effects from cascading effects which will result from a typical financial transaction of the non-financial company.

- **Direct effects** cover the additional costs of a possible direct tax liability resulting from transactions of the corporate pension schemes (art. 10 para. 1). In addition, they include the FTT costs of the financial transaction partner which result from a specific transaction with the non-financial customer. It is assumed that these FTT costs are passed on to the consumer.

Apart from that, there is also a common liability for the resulting tax liabilities (art. 10 para. 3).

- **Indirect effects** are second-round effects that necessarily result from an initial transaction. It is assumed that these effects will also be passed on to the customer. For example, banks typically outplace the risk from a typical derivative transaction (or parts of it) with a non-financial customer to another bank and/or the capital markets. Our methodology assumes that 50 percent of the initial position will be transferred to the capital markets. Also, the buying or selling securities usually involve a chain of transactions which are also liable for FTT. The cascading effects are conservatively modelled by assuming short transaction chains. Namely we assume that the non-financial customer does not use brokerage services but instead contracts directly with a clearing member.

Second, we calculate what will happen when the 24 sample companies are considered as "financial institution" within the FTT framework. The assumptions were subordinated to those described in Sections 2.2 to 2.5 of this position paper.

In combining the effects above four different scenarios have been calculated separately:

- **Scenario 1:** The costs of the FTT are calculated taking into account direct effects only as described above. Within the non-financial group only pension schemes are regarded as "financial companies" in the sense of the FTT proposal (See section 2.2 and 2.5 of this position paper).
- **Scenario 2:** This estimate also includes unavoidable tax cascades (indirect effects). It is assumed that these unavoidable cascading effects are also passed on from the financial institution to the non-financial end user and the pension schemes (see Section 2.3 of this position paper).
- **Scenario 3:** As in scenario 1, only the direct effects are calculated. But it is assumed that non-financial companies as a whole will be classified as financial institutions according to art. 2 para 1 no. 8 lit. j. As a consequence the non-financial companies will be taxed directly and internal derivative transaction will be in the scope of the FTT. This often leads to a duplication of the tax burden (see Section 2.4 of this position paper).
- **Scenario 4:** As in scenario 2, the "inevitable" cascade effects are detected. Also, non-financial companies are classified as financial institutions as in scenario 3, and are therefore subject to direct tax liability.

### 3.2 Results of the impact study

In total, 24 companies with over 1.8 million employees in Germany and worldwide sales of more than EUR 1,100 billion have taken part in the study. These companies expect – depending on the scenario – the following FTT costs:

- The direct tax impact alone will sum up to EUR 603 million in the baseline scenario 1 and EUR 1,041 million in scenario 3.
- As noted above it has realistically to be assumed that the non-financial companies must also bear the cascading effects of unavoidable transaction that are triggered by an initial transaction. If these indirect effects are taken into account additional costs of at least EUR 492 million will arise in both scenarios.
- Thus, non-financial companies will bear a total tax burden of EUR 1,095 million (scenario 2) and of EUR 1,533 million in the case of classification as a financial institution (scenario 4). The indirect effects count for 45 percent respectively 32 percent of the total tax burden.
- As noted above the calculations are conservative estimates because they only take into account unavoidable cascading effects. Also, in addition to the central treasury unit or the holding company further group entities may be designated as financial institutions in the meaning of the FTT proposal, if they also do not have sufficient operating revenue. This additional effect on the amount of the tax burden has also been neglected in our impact assessment.

<b>Scenario 1</b> (direct effects only, corporate is not regarded as „financial institution“)  <b>FTT burden: EUR 603 million p.a.</b>	<b>Scenario 2</b> (direct and indirect effects, corporate is not regarded as „financial institution“)  <i>+ additional costs compared to scenario 1:            EUR 492 million p.a.</i> <b>FTT burden: EUR 1,095 million p.a.</b>
<b>Scenario 3</b> (direct effects only, corporate is regarded as „financial institution“)  <i>+ additional costs compared to scenario 1:            EUR 438 million p.a.</i> <b>FTT burden: EUR 1,041 million p.a.</b>	<b>Scenario 4</b> (direct and indirect effects, corporate is regarded as „financial institution“)  <i>+ additional costs compared to scenario 3:            EUR 492 million p.a.</i> <b>FTT burden: EUR 1,533 million p.a.</b>

Chart 3: tax burden in different scenarios

The analysis also does not include the more indirect, but also economically significant negative effects on the real economy. These include for example the foreseeable reduction of the liquidity of shares and bonds in the secondary markets and thereby increasing financing costs and investment risks. Also the administrative costs of implementing and enforcing the financial transaction tax has been neglected (see sections 2.6 and section 4 of this position paper).

## 4 Additional negative impact on non-financial companies

In addition to the quantified impact there are a number of other negative effects of the FTT, which were not included in our calculation, e.g. the negative impact on market liquidity which will lead to a dry up of certain market segments. Therefore, the calculation in chapter 3 of this position paper should be regarded as extremely conservative in terms of the overall economic impact.

### 4.1 Increase of transaction costs, higher volatility and drying up of market segments

As a number of studies (and even the European Commission itself) has demonstrated the FTT will significantly reduce market liquidity. Reduced liquidity will transfer either into increased volatility of securities prices or – in a number of market segments – in a drying up of the market as a whole. In short: Risks in financial markets will be increased due to the FTT, which runs perfectly counter the political aim of the FTT to reduce risks.

These effects will also cause additional costs that must be borne by the companies of the real economy. For example, increased volatility will mean that investors call for higher risk premiums which in turn translate into higher costs of finance. Small and medium-sized companies whose shares or bonds are less liquid than those of the blue chips in any case will be hardest hit by this drain of liquidity, because their investor base may even completely dry up. The stated aim of the European Commission to improve access to capital markets especially for small and medium enterprises would thus be turned to absurdity (see e.g. the goal expressed in the Commission's Green Paper on long term investments recently published).

The same will happen to short-term finance via commercial papers, even if the issuing privilege will be extended to commercial papers which form a key instrument for short-term funding for non-financial companies. From the perspective of investors commercial papers are direct substitutes for bank deposits with similar maturity. Given their short maturity (mainly between one day and three months), the interest rate is rather low. A tax of 0.1 percent (without cascading effects) on these short-term instruments would compensate the relatively small yield. At least it would compensate the spread to comparable bank deposits, so that investors will no longer be willing to provide short term finance in the commercial paper market.

This will harm non-financial companies in two ways. Firstly, an important financing instrument falls apart. Secondly, holding cash reserves in short-term bonds or money market funds will turn out to be unattractive. In sum, the drying up of the commercial paper market will increase both funding and investment risks for non-financial companies.

In addition, at a higher volatility, it is difficult and more expensive, to hedge business risks because bid-asks spreads will increase. Oliver Wyman has estimated this effect to another 110 percent of the tax burden for the FX derivative market. Also, due to higher transaction costs the availability of customized products may be reduced, because customized product regularly will react extremely sensitive to reduced liquidity. Customised derivatives are, however, particularly important especially for the corporate risk management.

## 4.2 Impact on risk management structures

Today, many non-financial companies hedge at least a part of their operative risks individually with a customised derivative contract (called micro hedging) in order to reflect business risks as perfectly as possible. Given that the basis of FTT is the nominal value of derivatives an incentive is created to combine several underlying businesses and hedge their net risk with a derivative contract of long maturity (macro hedging). Such a strategy may reduce the total value (or taxable nominal value) of the hedged position, and thus the tax burden.

However, several problems will arise from macro hedging: First, macro hedges do not exactly reflect the structure of the individual positions (e.g. the required degree of risk mitigation or the maturity) which reduces the effectiveness of risk management. Second, accounting issues will arise because macro hedges may not qualify for hedge accounting under IFRS. This would increase the earnings volatility of the non-financial company, as the respective derivative would have to be run directly through the profit and loss account. The incentive to enter into derivatives with a longer maturity is, thirdly, increasing the corresponding counterparty risk.

## 4.3 Taxing collateral?

Pursuant to art. 2 para. 2 no. 2 the transfer of the risk associated with the financial instrument will be regarded as a taxable financial transaction. Thus, the posting of collateral in form of securities could also trigger taxation. This contradicts efforts to promote central clearing (which is always connected to a corresponding posting of collateral) or the bilateral collateralisation of derivatives transactions under EMIR. In addition, although the exceptions granted to the hedging activities of the real

economy under EMIR are appropriate, some companies already voluntarily use central clearing and/or bilateral collateralisation in their risk management procedures. The taxation of these transactions would significantly increase the cost of doing so.

#### 4.4 Inadequateness of nominal values as a tax base

For derivatives the tax base will be the notional amount. This is extremely problematic since the notional amount only reflects the value of the underlying business of the respective derivative (e.g. the value of the shares within a future on shares), but not the actual value of the derivative at the time of the transaction. The value of a derivative may be positive, zero or even negative, depending on how the underlying business develops. Therefore, the value of the underlying business is not an appropriate tax base. The market value is also unsuitable as is usually zero at the time the transaction is executed. This dilemma clearly demonstrates that it will be impossible to tax derivatives transactions appropriately.

#### 4.5 Concern on joint liability

Non-financial companies are extremely concerned about the joint liability for the tax payment under art. 10 para. 3 as they usually also contract with banks that domicile outside the EU (or the eleven member states). According to art. 4 para. 1 lit. f third-country financial institutions will also be taxable if their transaction partners are based in the EU. This will mean that, for example, a German non-financial company will be liable for the tax debt of a U.S. bank. Since tax authorities have no enforcement powers vis a vis an U.S. bank it is very likely that the German non-financial will finally have to pay the tax.

Even worse, the European Commission's proposal on the "residence" (art. 4) is extremely complex. For example, it is far from clear that resident A of a participating country will be able to identify whether or not a transaction partner B is a financial institution in accordance with the FTT proposal. B might for example be a typical non-financial company which may qualify as a financial institution under art. 2 para. 1 no.8 lit. j (what B may himself not know or not want to reveal).

#### 4.6 Abuse rules are not justified

The anti-abuse rule of art. 13 is misguided, since the required examination of the “commercial substance” of structures in art. 13 paragraph 3 contradicts the nature of FTT as tax on transactions. This also rises the question to what extent these provisions violate the free movement of capital.



## 5 Additional shortcomings of the FTT



The revenue estimated by the European Commission is too ambitious. It is also flawed to assume that the FTT could efficiently abandon "inefficient transactions" and would not harm retail investors.

### 5.1 Revenue forecast is too ambitious

The European Commission estimates the annual revenue of the FTT between Euro 30 and 35 billion per annum. For various reasons this estimate is too ambitious.

Basically, the FTT belongs to the category "regulatory taxes" with the aim to provide disincentives for transactions which "do not enhance the efficiency of financial markets". In case of success transaction volume will decrease and therefore the tax base will erode. Overall, tax revenue is reduced to the same extent as the regulatory aim to contain "speculation" is achieved.

In addition, market participants will relocate their activities in untaxed jurisdictions as the FTT is not introduced globally. The introduction of the financial transaction tax in Sweden should be taken as an example. As the revenue from the tax was correspondingly low Sweden decided to abandon this failed experiment in 1991. The same is likely in France and in Italy, where revenues are likely to be much lower than expected.

Compared to the design of the Swedish financial transaction tax the concept of the European Commission is less prone to tax avoidance. Nevertheless, the "residence principle" and the "issuance principle" does not prevent relocation in untaxed areas with the result that the revenue will be far smaller than expected.

Despite these "safeguards" many market participants are not necessarily bound to the financial centres of the participating member countries. Thus, a large part of the derivatives business will in future no longer be executed by EU-banks, but by financial institutions outside the scope of the FTT. A similar trend can be expected with regard to high frequency trading which accounts for a significant share of stock market turnover. While there is the stated aim of the legislature to curb this market practices this should not obscure the fact that the revenue from the tax will be reduced accordingly. The example high frequency trading illustrates dramatically the indissoluble conflict between the objective to curb "non-efficient" transactions and the goal of generating high revenue. Taking into account the relocation activities the tax revenue will mainly be collected from transactions of market par-

ticipants that can not relocate their financial activities. Those include in particular retail investors and large parts of the real economy.

Finally, the costs of tax administration and collection must be considered. For every Euro tax revenue costs for monitoring, tracking of avoidance reactions etc. are incurred. These costs can again significantly reduce the revenues of the FTT. In addition, market participants have to implement processes to calculate the tax and to administer its payment. Furthermore, it is completely unclear for example how the FTT can be collected from market participants outside the scope of the FTT. The European Commission has therefore introduced the joint liability of both transaction partners irrespective if they are a financial institution or not. This could mean that a non-financial end user is required to pay FTT for their financial counterparties.

## 5.2 Limits to „inefficient“ transactions?

It is one objective of the European Commission to discentivise "inefficient" transactions. However, it is very questionable whether "inefficient" transactions can be accurately identified. Take for example high frequency trading where a number of studies show that high-frequency traders usually act as market makers and enhance liquidity / market quality. Therefore, it is misleading to describe high frequency trading as "inefficient" per se.

Moreover, it is questionable whether the FTT is an adequate regulatory instrument to limit "inefficient" transactions. Here again the example of the high-frequency trading can be taken. Abusive practices of high frequency traders need to be addressed without doubt. But this has already been done or will be done by specific pieces of regulation such as the German "High Frequency Trading Act" by the of MiFID on European level. To misuse the financial transaction tax for "regulatory" goals is neither helpful nor necessary.

## 5.3 Decreased attractiveness of capital market products harms retail investors

The FTT is not only an enormous additional burden on non-financial companies but also harms retail investors. Given declining shareholder numbers tax-induced costs would be a bitter blow on the equity culture, for example in Germany. An additional tax would be the wrong signal to investors and would contradict the political aim to expand private old age provisions in times of declining efficiency of the governmental pay-as-you-go-system.

One should also be aware that the tax rate of 0.1 percent per transaction is only apparently low because of the cascade effects (see Section 2.3 of this position paper). Furthermore, although the issuance of investment funds is exempted from the tax (see recital 9) the sale of fund units will be taxed in the secondary market. .

Moreover, the managers of mutual and pension fund adopt their portfolio structure in certain intervals. The turnover rate is 86 percent p.a. for equity investment funds, mixed investment funds at 59 percent and 54 percent for fixed income investment funds (median; reference year: 2011). Each of these transactions will be taxable in future, which - depending on the frequency of transactions - would also represent a significant additional burden that would ultimately to be borne by the retail investors in the form of higher costs (lower returns).

## 6 Conclusion

Overall, the European Commission's proposal for the introduction of an FTT does not achieve any of the desired objectives. The burden of the FTT has to be borne in first place and to a considerable extent by the real economy and retail investors; those, who – according to the political declarations of intent – are not in the focus of the FTT. The FTT will not raise the revenue as expected and is not an adequate regulatory instrument to increase the stability of the financial system.

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