Ref.: S2017-1860  

Subject: Financial transaction tax and its management

Pursuant to the provisions of Article L. 111-2 of the financial courts code, the Cour des comptes conducted an investigation on the implementation and management of the financial transaction tax.

Following its assessment, the Cour des comptes asked me to call your attention to the following observations, pursuant to the provisions of Article R. 143-11 of the same code.

The supplementary finance act for 2012, no. 2012-354, dated 14 March 2012, instituted a financial transaction tax\(^1\). This measure was part of discussions initiated at the European level during the financial crisis of 2008. On 28 September 2011, the European Commission thus released a proposed directive to institute a financial transaction tax in all the Member States. This proposal has yet to be implemented to date.

By instituting such a tax, the Government pursued three objectives:

- have the financial sector contribute to the recovery of public finances;
- regulate the financial markets, particularly on the most speculative activities;
- initiate a movement to have other States accede to the Commission’s plan.

While the budgetary performance of the tax is real (around 1 billion euros), none of its three strategic objectives has been achieved.

Moreover, the extension of the tax base, adopted in the finance act for 2017 and due to enter into force on 1 January 2018, faces significant implementation difficulties.

Lastly, management of the tax, and especially its control, must be improved.

\(^1\) With an effective date of 1 August 2012.
1 WHILE THE BUDGETARY PERFORMANCE OF THE TAX IS REAL, NONE OF ITS THREE STRATEGIC OBJECTIVES HAS BEEN ACHIEVED

Adopted in March 2012, the financial transaction tax has three components:
- a tax on purchases of equity securities or similar instruments (mainly shares);
- a tax on cancelled high-frequency trading orders;
- a tax on purchases credit default swaps (CDS) of a State.

The aim of the first component was to have the financial sector contribute to the recovery of public finances, in return for the public support that it received during the 2008 crisis. The tax rate, initially set to 0.1 per cent, was increased to 0.2 per cent starting with the 2012 second supplementary finance act, just before its entry into force. It was increased to 0.3 per cent by the initial finance act for 2017.

The other two components of the tax targeted particularly speculative activities, with the objective of limiting or even eliminating them. High-frequency trading operations, accused of causing irrational variations in stock prices, should thus be taxed once the proportion of cancelled orders exceeds a certain threshold. Similarly, the taxation of purchases of credit default swaps (CDS) on a debt security of a State of the European Union concerned only "naked" purchases, i.e., purely speculative trades on sovereign debt.

The assessment of the implementation of these taxation schemes has fallen short of the expectations.

1.1 THE TAXATION PUTS NO WEIGHT ON THE FINANCIAL SECTOR, BUT ON THE CLIENTS OF FINANCIAL INTERMEDIARIES

The tax yield, derived solely from the component pertaining to purchases of equity securities or similar instruments, totalled €947 million in 2016. It decreased slightly, whereas it had increased steadily from 2013 to 2015, from €766 million to €1.058 billion. Approximately one quarter of this amount comes from taxpayers established in France. According to the AMF (French financial markets authority), the introduction of the tax in 2012 resulted in a reduction of approximately 10 per cent in the volume of transactions on the securities concerned.

However, contrary to one of its initial objectives, this taxation of purchases of shares puts no weight on the financial sector. The tax is settled and owed by the investment services provider (ISP) that performs the transaction, which legally makes the ISP liable for the tax. However, ISPs pass the cost on to their clients when they charge them transaction fees.

Investors are therefore the ones who ultimately bear the burden of the tax and not the financial sector. That is also why it is relatively well accepted by professionals.

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2 The other securities within the scope of taxation are particularly investment certificates, voting certificates, and certificates representing shares.
3 According to the terms of the Bulletin Officiel des Finances Publiques (French official public finance bulletin), Credit Default Swaps (CDS) "are financial protection contracts whereby the buyer of protection pays a premium to the seller of protection in exchange for which the buyer receives the right, in the event of a credit event affecting the State, either to obtain a sum corresponding to the difference between the nominal value and the market value of the sovereign bonds, or to deliver these bonds against the payment of a price corresponding to their nominal value".
4 A CDS purchase is called "naked" when it is not used to hedge a risk to which the beneficiary would be exposed, i.e., when the beneficiary does not hold debt securities or another asset whose value is correlated with that of the debt. In this case, the purchaser buys the CDS only for speculative purposes, betting on a decline in the value of the debt security.
5 The initial forecasts valued the annual tax yield at €1.6 billion.
6 Nevertheless, investment services providers are responsible for paying the tax when they carry out proprietary trades (and as long as these trades are not eligible for an exemption). In France, since the act on the separation...
1.2 IN REALITY, THE MOST SPECULATIVE ACTIVITIES ARE NOT TAXED

As for the taxation of high-frequency trading, a particularly speculative activity, it has a zero yield.

Several explanations can be given, such as the setting of the taxation threshold to a high level \(^7\) or the exemption of market-making activities \(^8\), which represent the bulk of high-frequency operations. However, regardless of the relevance of each of these explanations, the limitation of the scope of the tax to only trades carried out by "enterprises operated in France" allows the tax to be avoided by moving transactions abroad.

The tax therefore has not forced the targeted "harmful" operations to disappear; it has only moved them to other countries.

With regard to the taxation of "naked" purchases of sovereign CDS, it has become moot since the implementation of the FTT, given that EU Regulation 236/2012 of 14 March 2012 on "short selling and certain aspects of credit default swaps" has prohibited these "naked" purchases, a prohibition that has thus allowed the objective of the tax to be achieved directly.

1.3 THE INTRODUCTION OF A TAX IN FRANCE HAS HAD NO RIPPLE EFFECT AT THE EUROPEAN LEVEL

Disagreements among the Member States, in discussion since 2011 and now at ten countries within the framework of enhanced cooperation, have prevented the implementation of taxation of financial transactions at the European level. The ambition to establish a tax with a broad base, including shares, bonds, and derivatives, has thus sparked opposition from some Member States. Similarly, no agreement could be reached on how the proceeds from the tax would be distributed among the participating countries.

2 THE EXTENSION OF THE BASE ADOPTED IN THE 2017 INITIAL FINANCE ACT FACES SIGNIFICANT IMPLEMENTATION DIFFICULTIES

The base of the financial transaction tax was expanded to intra-day transactions by the finance act for 2017. This expansion is due to enter into force on 1 January 2018. The postponement of the entry into force of this new provision by one year is explained by the technical difficulties that the tax administration will need to overcome for the concrete implementation of the scheme.

Today, the tax applies to transactions giving rise to a transfer of ownership, which results in the "delivery" of the security, materialised by its recording in the purchaser's securities account \(^9\). The reference to transfer of ownership, and therefore to the delivery of the security, has two consequences:

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\(^7\) The tax is triggered only if the proportion of cancelled or modified orders exceeds 80 per cent in the same day.

\(^8\) A market maker intervenes to allow any investor to carry out the desired transaction (purchase or sale) when there is no counterparty on the market at the same time. The market maker will be responsible for entering into a transaction in the reverse direction later.

\(^9\) Investing on financial markets requires opening a securities account, with a custody account-keeper, authorised by the French prudential supervision and resolution authority (ACPR) and under the supervision of the French financial markets authority (AMF). The securities account records all securities acquired by its holder. It is...
- the tax is based on the amount of purchases net of sales in the same day (see box below);
- the taxable event is a legal act governed by French law, which constitutes the basis of taxation by France of transactions carried out abroad.

A base currently limited to purchases net of sales in the same day

As a general rule, the delivery of a security is performed two days after the transaction. If a person carries out purchases and sales on the same security in the same day, only the balance of these trades gives rise to delivery. If the purchases exceed the sales, the tax is due on the difference between the two, i.e., on the amount of purchases net of sales ("net long position"). If sales exceed purchases, no tax is due since the transactions of the day result in a net sale. The tax therefore does not apply to purchases offset by a sale in the same day (intra-day transactions).

The extension of the base to intra-day transactions amounts to taxing the transactions, including when there is not resulting transfer of ownership. Therefore, the taxable event, which can no longer be the transfer of ownership, will be complex to define and will make it difficult to define the technical procedures\(^\text{10}\) for declaration and control of the tax.

With regard to transactions carried out abroad, the question of the taxable event is particularly important insofar as it forms the basis for France's legitimacy in levying a tax on such transactions. The disappearance of the concept of transfer of ownership in the definition of the taxable base could fuel numerous disputes on the territoriality of the tax.

The Government should initiate discussions as part of the next finance act to eliminate these difficulties before the actual implementation of the extension of the FTT base to intra-day transactions.

3 IMPROVEMENTS MUST BE MADE TO THE MANAGEMENT AND CONTROL OF THE TAX

The management of the financial transaction tax relies on a collection mainly done by Euroclear France, the only central securities depository\(^\text{11}\) authorised in France by the AMF, bound to the financial administration by a protocol entered into on 7 September 2012 with the French directorate general of public finance (DGFiP) and the French directorate general of the treasury (DGT).

\(^\text{10}\) At the meeting of 15 December 2016 at the National Assembly, Christian Eckert, Secretary of State for the budget and public accounts, indicated that "the contacts made with the sector's professionals […] reveal that it is absolutely impossible to implement schemes to recover the tax, because that would require changing the computer systems used to process trades of the financial intermediaries as well as a large number of agreements between these intermediaries and the clients".

\(^\text{11}\) A central securities depository has a dual role:
1. The central securities depository is the link between companies that issue securities, which deposit their securities with it, whether or not they are admitted to or traded on regulated markets or multilateral trading facilities, and the financial intermediaries that hold these securities on behalf of investors or on their own account. This is the central securities depository function proper;
2. The central securities depository also allows financial intermediaries to deliver securities against payment following trades or disposals. This is the settlement system operator function (source: AMF).
After more than four years of implementation, the management of the financial transaction tax requires improvements, particularly as regards the organisation of controls and the arrangements for remuneration of Euroclear France.

3.1 THE PROTOCOL ENTERED INTO BETWEEN THE ADMINISTRATION AND EUROCLEAR FRANCE IN 2012 MUST BE REVIEWED

Decree no. 2012-956 of 6 August 2012\(^{12}\) (relating to methods of declaration by taxpayers and collection by the central securities depository of the financial transaction tax) specified the methods of declaration of transactions by taxpayers to the central securities depository, as well as the conditions for collection and repayment of the tax by the central securities depository to the administration. The rules for implementing these regulatory provisions were specified in the protocol of 7 September 2012.

According to these provisions, Euroclear France collects information\(^{13}\) from taxpayers\(^{14}\), levies the amounts due from their accounts, and pays them to the French directorate of large enterprises\(^{15}\) (DGE). Euroclear France also sends to the tax management department of the DGFip a summary of taxpayers’ declarations and the results of controls\(^{16}\), aimed at detecting any inconsistencies in the declarations or behavioural anomalies of taxpayers.

In addition, in accordance with the protocol, since March 2013, Euroclear fulfils its reporting obligations to the DGE by producing an annual report. The examination of this document leads to the conclusion that it does not contain all the information expected by the administration and provided for in the protocol.

Following the investigation conducted by the Cour des comptes, the DGFip expressed its intention to carry out, with Euroclear France, a review of the protocol after four years of implementation and to amend it, particularly to enrich the collected data. This review will be all the more essential if the extension of the tax base occurs in January 2018 in accordance with the 2017 initial finance act (LFI).

3.2 INSUFFICIENCY OF ADMINISTRATIVE CONTROLS

The verification of declarations and collection of the financial transaction tax is insufficient: on the one hand, the administration is unaware of all the transactions subject to tax; on the other hand, the verification comes up against many legal and technical difficulties.

Despite its function as central securities depository, Euroclear France has no knowledge of all the transactions potentially subject to tax.

This is particularly because settlement/delivery operations occur at the end of the processing of transactions and pertain to consolidated amounts, with purchases offset by sales\(^{17}\). This is also explained by the possibility for purchasers to carry out the settlement/delivery with another central securities depository (in this case, the international central securities depository, Euroclear Bank).

\(^{12}\) Codified in Articles 58Q and 58R of Annex III of the French general tax code (CGI).

\(^{13}\) They include, in addition to the amount due for the taxation period, detailed information about transactions: order numbers of the transactions concerned, date of their execution, description, number and value of securities for which purchase is taxable, and exempt transactions.

\(^{14}\) In the event of a direct declaration to the DGE, the form to be submitted by the taxpayer is extremely simplified because it includes only the total amount of tax payable.

\(^{15}\) Department with national jurisdiction attached to the DGFip

\(^{16}\) Provided for in Article 58 R(IV)(1) and (2) of annex III of the French general tax code.

\(^{17}\) This offsetting is done at the financial intermediary level: the settlement/delivery at its level concerns the difference between the purchases made by some of its clients and the sales made by other clients.
Moreover, and contrary to the regulatory provisions, Euroclear France has never signed an agreement with trading platforms or clearing houses in order to obtain information about the transactions carried out and compare them with those declared to it.

The application of the tax can therefore only be verified subsequently by examining the list of transactions for each taxpayer. This verification is done by the national and international audit directorate (DVNI) and is limited in scope.

The weakness of the current verifications calls for new actions on the part of the administration aimed particularly at improving information exchanges between the managing departments, in order to establish an audit plan and clarify the application of certain points of the legislation.

3.3 AN INCORRECT BUDGET ALLOCATION OF EUROCLEAR FRANCE’S REMUNERATION

According to the laws and regulations as well as the protocol between the administration and Euroclear France, Euroclear France’s remuneration for its function of collecting the FTT is ensured by the payment of interest by France’s treasury agency (Agence France Trésor). The central securities depository has the obligation to deposit the amounts of tax that it has collected into an account opened with Agence France Trésor between the 6th and the 25th of each month.

Deposits into this account bear interest at a fixed rate of 0.35 per cent in accordance with the decision of the Minister of the Economy and Finance of 30 October 2012.

This method of remuneration is questionable in several respects.

On the one hand, the rate of 0.35 per cent paid on the amounts deposited with the Treasury by Euroclear France is much higher than the market's short-term interest rates, currently negative. Contrary to what was provided for in the Minister's decision, it has never been reviewed. Under the guise of remunerating deposits, it actually involves guaranteeing a certain amount of remuneration to Euroclear France.

On the other hand, since it involves paying for a service, a sincere budgetary presentation of Euroclear France’s remuneration should have led to its appearance not in interest expenditure (falling within the State’s financial commitments mission), but in tax management expenditure (attached to the public finance and human resources management mission). The DGFiP has indicated to the Cour des comptes that it wishes to reflect on this subject.

Beyond the difficulties in implementing the extension of the taxable base of the financial transaction tax on 1 January 2018, to which the Cour des comptes wishes to draw your attention, it hereby makes the following recommendations:

- **Recommendation 1:** Update the protocol, in view of the review of the initial years of implementation, particularly aiming to specify the arrangements for control and collection of the financial transaction tax;

- **Recommendation 2:** Make the State's methods for offsetting the cost of collection and management of the tax by Euroclear France compliant with the by-law relating to finance acts of 1 August 2001 (no. 2001-692).

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18 Article 58 R(IV)(3) of annex III of the French general tax code
19 Department with national jurisdiction attached to the DGFiP.
I would be grateful if you would let me know, within the period of two months provided for in Article L. 1434 of the financial courts code, your response to this communication, under your signature.\(^{20}\)

I remind you that pursuant to the provisions of the same code:

- two months after it is sent, these observations to the government will be forwarded to the finance committees and, within their scope of jurisdiction, to the other permanent committees of the National Assembly and the Senate. It will be accompanied by your response if it reaches the Cour des comptes within this period. Otherwise, your response will be sent to them as soon as the Cour des comptes receives it (Article L. 143-4);

- in respect of the secrets protected by law, the Cour des comptes may post these observations to the government on its website, accompanied by your response (article L. 143-1);

- Article L. 143-9 provides that, as recipient of these observations to the government, you must provide to the Cour des comptes a report on the follow-up to its observations for presentation in its annual public report. This report must be sent to the Cour des comptes according to the methods of the coordinated annual monitoring procedure agreed upon between it and your administration.

Didier Migaud

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\(^{20}\) The Cour des comptes kindly asks that you forward your response, in electronic form, via Correspondance JF (https://correspondancejf.ccomptes.fr/linshare/) at the following e-mail address: greffepresidence@ccomptes.fr (see the ruling of 8 September 2015 implementing decree no. 2015-146 of 10 February 2015 relating to the dematerialisation of exchanges with financial courts).