The French “financial transaction tax” (FTT) came into effect on 01 August 2012. It is comprised of three taxes: one on equity instruments, one on high frequency trading (HFT) and one on naked sovereign credit default swaps (CDS). Some useful interpretative documents, namely, a Statement of Practice dated 02 August and a Decree dated 06 August 2012, have subsequently been published. In addition, a Protocol relating to the tax on equity instruments has recently been released by the Association for Financial Markets in Europe (AFME).

Tax on equity instruments

This tax applies to any transfer of an equity instrument listed on a regulated market (French or foreign) issued by a company with a registered office in France and a market capitalisation of over €1 bn. A list of French companies liable for FTT will be published annually by the Treasury Department. The first one, to be used for 2012 transactions, may be found at the following address: [http://www.legifrance.gouv.fr](http://www.legifrance.gouv.fr)

For FTT purposes, “equity instrument” is very widely defined and includes shares and other equity instruments which give or can give rise to capital or voting rights. Acquisitions of certificates representing French shares, such as American Depositary Receipts (ADRs), are also taxable, even if issued by foreign entities. After some debate, however, taxation of such instruments has been postponed until 01 December 2012.

The transfer of the equity instrument must be for consideration and must result in a change of ownership (e.g. a spot trade, forward sale etc.). A purchase of securities resulting from the exercise of an option or from the physical delivery of securities associated with the settlement of a derivative transaction is fully taxable. Where the delivery of securities is not immediate (e.g. in the case of a deferred settlement service), only the net position of the purchaser at the end of a given period (e.g. the end of the day for intra-day transactions or the end of the month for French deferred settlement transactions) is taxed. Cash settled derivatives or warrants are exempt, as are index-linked transactions and exchange traded funds.

Certain activities are also exempt, such as those carried out by clearing houses, central securities depositaries or market makers. Market making activities are broadly defined as activities carried out by a broker or bank when acting as an intermediary in respect of certain transactions involving financial instruments (including derivatives). The market maker must be involved in: (i) market making (for the market making leg), such as contracting with a trading platform or providing OTC liquidity for an instrument, (ii) facilitation or warehousing, when trading on its own account to facilitate execution of a client order (i.e. to provide additional liquidity) or (iii) hedging of positions linked to (i) and (ii) above.

Furthermore, certain instruments or transactions are themselves excluded from the scope of the tax. In particular, these include convertible and exchangeable bonds, primary market issuance operations, securities lending, repos, buy-sell back or sell-buy back transactions, intra-group transactions, employee share programmes and transactions carried out on behalf of the relevant issuer under a liquidity agreement.

The tax, applied at a rate of 0.2% (it was initially 0.1%, but subsequently doubled) on the consideration paid for the equity instrument, is payable by the investment firm executing the purchase order (the investment services provider (ISP)) as an intermediary or for its own account, regardless of its location. In the absence of such an ISP, tax is due from the central securities depository, also regardless of its location. Where an ISP transfers an order to another ISP (for execution) to purchase taxable securities for its own account, the ISP legally purchasing these instruments is the one liable to the tax. Finally, when several ISPs are involved in the execution of a purchase order as intermediaries, i.e. for a final purchasing client (purchase being effected in the name and on behalf of such purchaser), the ISP who is liable to the tax is the first ISP to have received the purchase order for execution from this final client.

AFME has recently issued a Protocol intended to allow adhering market participants who are ISPs to allocate the liability for FTT on transactions between themselves. In broad terms, the Protocol provides that the purchasing ISP will be responsible for any tax reporting and tax payment obligations relating to the FTT, either directly, through a nominee or, in the case of payments, through the relevant central securities depository. The purchasing ISP also indemnifies the selling ISP in relation to costs, including the FTT itself, for which the selling ISP is liable following a binding direction from the
French tax authorities that the selling ISP should pay the FTT, whether as a result of the failure of the purchasing ISP to comply with its obligations or otherwise. It is possible to disapply the Protocol in relation to transactions with particular counterparties or to withdraw entirely from its provisions, although only in each case in respect of future transactions. Although the Protocol does little more than reflect the position at law, and could therefore be considered more a code of best practice, from a commercial perspective, ISPs may in practice find it beneficial to adhere to the Protocol.

The tax is due, in principle, on a monthly basis, except for transactions carried out during August, September and October 2012, on which tax will only be due by the end of November 2012.

**Tax on HFT**

This tax applies to enterprises carried on in France, i.e. to legal entities incorporated or set up in France and to foreign companies established in France for tax purposes (e.g. French branches), which engage in HFT for their own account. Transactions effected by French companies through their foreign establishments (e.g. branches) remain outside the territorial scope of the tax.

For French FTT purposes, HFT is defined as the use of an automated system to transmit, change or cancel a series of orders for a given “equity instrument” (as defined above, but here regardless of the nationality or market capitalisation of the issuing company) - such orders being separated by less than 0.5 seconds. For any given equity instrument, this period of time is assessed in terms of the median period of time, calculated over the month preceding the transaction, between the point at which the order to purchase or sell is made and the subsequent order intended to modify or cancel it. Market makers are specifically exempt.

The tax is applied at a rate of 0.01% on the value of the orders which are cancelled or modified, but only applies to the portion of such orders exceeding a certain daily cancellation rate threshold, which has been set at 80%.

The tax is due on a monthly basis.

**Tax on naked sovereign CDS**

This tax applies to individuals tax resident in France, to legal entities incorporated or set up in France and to foreign companies established in France for tax purposes (e.g. French branches), which acquire CDS on EU sovereign debt. Market makers are also specifically exempt from this tax.

The tax is calculated at a rate of 0.01% on the notional value of the CDS. However, no tax is due where the beneficiary of the CDS holds a long position on the related sovereign debt, or assets or instruments the value of which is linked to such debt.

The tax is due on a monthly basis.