



Irish Stock Exchange

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Mr Jim Kelly,
Secretary,
Commission on Taxation,
Le Pole House,
Ship Street Great,
Dublin 8.

23rd May, 2008

Dear Mr Kelly,

Re: Irish Stock Exchange Submission to Commission on Taxation

The Irish Stock Exchange has set out below our submission for consideration by the Commission on Taxation.

The Exchange's submission focuses on what it considers to be the key issue for the Irish market of the necessity for reform of the Stamp Duty regime. The necessary reform, which urgently needs to be undertaken, is the abolition or substantive reform of Stamp Duty on Irish securities.

Abolition of Stamp Duty

The Exchange has consistently argued for the removal of the 1% Stamp Duty on the purchase of Irish securities. Ireland is one of the few developed jurisdictions to impose Stamp Duty on securities transactions. It does so at a rate of twice that prevailing in the United Kingdom, our main competitor market.

The Exchange's view is that the imposition of Stamp Duty on shares is seriously damaging to Irish companies, to innovation in Irish financial services and ultimately to the Irish economy. In fact the main burden of Stamp Duty is borne by ordinary savers and pensioners, especially through their investments in pension fund assets. The imposition of Stamp Duty on shares also goes against many of the policy aims of the Government.

Our arguments are supported by considerable independent research, in particular I would draw your attention to a report entitled "Stamp duty: its impact and the benefits of its abolition", published in May 2007 by the independent research group Oxera, which has also undertaken research for the Commission, numerous EU governments, regulators and major companies. This report was commissioned by the Association of British Insurers (ABI), the City of London Corporation, the Investment Management Association (IMA) and the London Stock Exchange (LSE). It provides a detailed analysis of the economic impact of Stamp Duty on securities in the United Kingdom and its conclusions support the key arguments made by the Exchange. The conclusions of the Oxera report have full, and sometimes even more pronounced, application in the Irish context.

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Our main arguments for the abolition of Stamp Duty are as follows:

1. Stamp Duty is counterproductive to encouraging savings and pension provision by individuals and households

A significant amount of Stamp Duty is levied on pension funds, savings and other collective investments managed by buy-side firms, as well as individual investments, making Stamp Duty a tax which ultimately impacts either directly or indirectly on individual investors. Stamp Duty of 1% on Irish listed securities acts as an additional cost burden on investment by pension schemes in Irish securities.

The Oxera report found that Stamp Duty constitutes a considerable cost to pensioners throughout the lifetime of their savings. Stamp Duty reduces the average value of every UK pension fund at retirement (in 2006 money) by approximately £6,441 and by approximately £11,538 for equity based portfolios. These costs are substantially more for investors in Irish pension funds, due to the higher rate of Irish Stamp Duty.

These significant costs mean that investment by Irish pension funds in Irish equities is less attractive than in other equities that do not attract Stamp Duty. Since the introduction of the Euro, the exposure of Irish pension funds to Irish equities as a proportion of total funds invested is falling and continues to fall below a level indicated by normal Eurozone diversification.

Statistics from the IAPF, available on its website, indicate that as at 31st December, 2007 Irish pension funds had grown to €86.6bn, representing a 65% increase in assets under management (AUM) by Irish pension funds from December 2000 when they amounted to €52.5bn. The value of Irish pension funds investment in Irish equities was 8.2% of AUM in December 2007 compared to 19% of AUM in December 2000. The opportunity cost is clear as the percentage invested in Irish equities is decreasing while at the same time the value of the funds invested is increasing.

We can expect to see pension funds continue to diversify away from exposure to Irish equities both by further purchases of European equities and by switching into alternative assets.

It is very difficult to reconcile how the policy of reducing investors' pension funds by levying a 1% tax on purchases of Irish securities by pension schemes fulfils the Government's aims of increasing the numbers of individuals with adequate financial provision for their retirement.

2. Abolition of Stamp Duty strengthens the economy

The Oxera report concluded that the rise in the value of listed companies expected if Stamp Duty were abolished would result in a permanent increase in UK GDP of between 0.24% and 0.78%.

There is considerable research which indicates that the existence of transaction taxes has a direct effect on market liquidity and the value of stocks. Research by SIRCA (the Securities Industry Research Centre of Asia-Pacific) found that the size of share

parcels traded is responsive to lower transaction costs. For each cut in transaction costs, the volume of trading increases and the size of share parcels increases.

Due to the expected increase in GDP, Oxera concluded that the abolition of tax would be neutral or beneficial for the Exchequer in the UK. A similar outcome would be expected in Ireland. Abolishing Stamp Duty would therefore increase trading volume and provide alternative benefits to the Government from increased investment and more efficient markets.

The experience of the impact of transaction taxes in other countries is instructive. For example, Australia, which has a very successful stock market, halved stamp duty in 1995 from a rate of 0.3% to 0.15% resulting in an increase in the average number of transactions of 25%. This had a positive impact on the Australian market, which in turn has a significant impact on Australia's GDP. The Australian Stock Exchange stated in 2000 that it estimated that AUD18bn of turnover in equities, which had gone overseas returned to the Australian stock market as a direct result of this reduction. Subsequently, stamp duty was completely abolished for shares traded on the Australian stock market in 2001.

In the current economic climate any opportunity to encourage growth should be taken.

3. Stamp Duty is counterproductive to encouraging investment in and innovation by Irish companies

The high transaction cost that Stamp Duty represents is a disincentive to companies to apply for admission to trading on the Irish Stock Exchange. This higher cost is particularly significant for small to mid-sized companies seeking admission to trading on the Exchange's Irish Enterprise Exchange ('IEX') market. This is in direct conflict with Government policy, under the National Development Plan, to encourage research and development spending in Ireland by Irish companies and with Enterprise Ireland's plans to support start up and early development stage business.

High costs in Ireland for securities transactions increase the overall cost of capital for companies seeking to raise funds. This again is of serious concern for the economy in markets now characterised by more expensive and less easily available credit.

The Oxera report found that the abolition of Stamp Duty would be likely to result in a significant increase in share prices and valuations of listed companies, and in a reduction in the cost of equity of listed companies. Oxera's research also indicated that this increase would be beneficial to sectors which have a high degree of equity fundraising, and which have a high velocity of trading in their shares.

The Oxera analysis concluded that the telecommunications, technology, and industrial goods and services sectors are potentially those most affected and likely to experience an increase in value if Stamp Duty were abolished. These are the activities which have been identified in the Government's 'Enterprise, Science and Innovation Priority of NDP 2007-2013'.

4. Stamp Duty is detrimental to the competitiveness of and innovation in the Irish securities market

We know from discussions with foreign based participants in the Irish equity market that significant numbers of their clients avoid trading in Irish securities purely because of Stamp Duty. While the current market turmoil has broadly impacted markets worldwide, the ISEQ has underperformed other market indices and in such circumstances the negative impact of exceptional costs such as Irish Stamp Duty acts as a further significant deterrent to participation in our market.

Stamp Duty has also proven to be a disincentive for innovation in the Irish market. For example, the covered warrant market on Irish shares failed to take off in Ireland while the economically equivalent but tax favoured contracts for difference market thrived. The hostile environment that Stamp Duty created for Exchange traded covered warrants was a very real issue in this regard. The position is that a covered warrant issued over an Irish company, which would be traded on the Irish Stock Exchange, would be deemed to be a marketable security with transactions in such a covered warrant being subject to stamp duty. However, if the issuer of covered warrants in Irish securities is a foreign based entity, the foreign based issuer could obtain an exemption so that any transactions in such instruments in the secondary market would be exempt from stamp duty (*ref: Section 88(1)(b)(iv) of the Stamp Duties Consolidation Act*). This clearly disadvantages Irish based firms, and is a disincentive against Irish firms issuing covered warrants in Irish securities. Our concern has been that an alternative market over Irish equities would develop abroad and it is noteworthy that foreign issuers have issued covered warrants over some of the main Irish companies, which are traded in the UK rather than in Ireland. Transactions in cash settled covered warrants admitted to trading on a UK market are not subject to stamp duty, which is a clear competitive disadvantage to the Irish market.

We believe that it is essential for the retention of Ireland's position as an important financial services centre that the Irish market continues to innovate and that such innovation should be supported rather than frustrated by the fiscal regime.

5. Higher transaction costs may lead to other investment behaviour which could be counterproductive to market transparency

The Oxera report concluded that higher transaction costs encourage investment in securities which do not attract Stamp Duty and investment strategies to which Stamp Duty can be rendered neutral, such as some hedge fund, private equity and derivatives based strategies.

In addition, we share Oxera's concerns in relation to possible distortions in market behaviour due to Stamp Duty. They identified that investors wishing to participate in the governance of public companies must own stock directly, while those holding derivatives are not required to do so. In addition, Oxera noted the movement of investors into other forms of securities which could affect the transparency and quality of markets. This 'decoupling' of the interests of derivatives investors from the ownership of the underlying stock is unwelcome.

6. Implications of MIFID

With the implementation of MiFID in November 2007, there is even greater ease of access by investment firms to other European jurisdictions and opportunities to invest in companies which have the attraction of no Stamp Duty. The logic of Ireland as an investment destination is being and will continue to be increasingly scrutinised by investment firms and asset managers in the context of the even more pan-European regime that exists since MiFID. This will affect the investment decisions of both Irish firms and other EU investment firms. Irish issuers need to compete with their international peers for inclusion in domestic and overseas institutional portfolios. The higher transaction costs due to Stamp Duty act as a disincentive to invest in Irish issuers compared to issuers in more benign and competitive jurisdictions.

It is clear also that there is a much greater, and increasing, focus by firms on the total costs of a transaction. In response to this environment of greater competition and price sensitivity, the Irish Stock Exchange has sought to position the Irish equity market to its best advantage. Since 1st November we have dramatically reduced the costs of trading from a range of €2.40 - €3.50 to a range of €0.25 - €1.50 per transaction. This is a flat rate charge regardless of the size of the transaction and is among the most competitive in Europe. As the Exchange's fees have decreased to become a tiny percentage of the total cost of a transaction, the 1% Stamp Duty charge stands out as a much greater percentage of the total transaction. For example, if you take a €10,000 purchase of any Irish equity by an investor, with the midpoint of the Exchange's revised charge being €0.875: this results in a charge of less than 0.01% of the transaction value compared to the 1% Stamp Duty levy of €100 for the same purchase. This level of tax charge is exceptional and strongly negatively differentiates Irish securities from all their other European, and indeed global, competitors.

MiFID requires that there must be no 'gold plating' on membership requirements which are detrimental to a level playing field, in keeping with the general aims of harmonisation. The imposition of Stamp Duty on shares is at odds with the spirit of a single securities market across the EU.

Conclusion

Our arguments tie into some of the Terms of Reference of the Commission, including:

- A. consider how best the tax system can support the economic activity and promote increased employment and prosperity while providing the resources necessary to meet the cost of public services and other Government outlays in the medium and longer term;
- B. consider how best the tax system can encourage long term savings to meet the needs of retirement;
- D. review all tax expenditures with a view to assessing the economic and social benefits they deliver and to recommend the discontinuation of those that are unjustifiable on cost/benefit grounds;

I would be happy to meet with the Commission to discuss the removal of Stamp Duty on transactions in Irish securities further should it be of assistance.

Yours sincerely,

A handwritten signature in cursive script, appearing to read "pp Brian Healy".

Brian Healy
Director of Traded Markets, Development and Operations