The Push for a Financial Transactions Tax

Financial transaction taxes (FTTs) refers to a group of taxes imposed on taxable financial transactions, such as buying or selling securities or currency, with an objective to discourage excessive speculation. The tax was first initiated in the U.K. as a form of stamp duty on the London Stock Exchange. The tax came to the U.S. in 1936, as a revenue raising mechanism during the Great Depression. During that time, a British economist named John Maynard Keynes, proposed levying a form of this tax on Wall Street transactions, because he believed that the tax would curtail financial traders from continuing to employ excessive speculation and consequently increasing market volatility. Thereafter, James Tobin, an American economist developed the idea of a currency transaction tax, now deemed the "Tobin Tax." A Tobin Tax is a tax on spot conversions and is intended to place a penalty on short term currency exchange transactions. As a result of the financial crisis that began in 2007, economists all over the world examined the Tobin Tax, and began developing different forms of financial transaction taxes. From there emerged several different kinds of FTTs- such as a Securities Transaction Tax (STT), which is a tax on trades in all or certain types of securities, and may include original issuance, or be limited to secondary markets. Other types of FTTs include capital levy or registration taxes; bank transaction taxes; and real estate transaction taxes.

The push for an FTT comes primarily from Europe, which has been quite actively promoting implementation of an FTT since the financial crisis. Within the past several months alone, the European Commission has met several times to discuss employment of the tax, and has recommended that all E.U. members adopt an FTT. Though it appears that the push for an FTT on an E.U.-wide basis has ended, member states are currently examining "enhanced cooperation," a process to bypass E.U. rules that require any tax initiative to get the unanimous consent of all 27 E.U. member states and instead allow only 9 member states to approve the tax. This compromise proposal would enact an FTT in the 9 member states that sign the enhanced cooperation agreement, while the rest of the member states have the option to join. The European Commission will vote on enhanced cooperation on October 9, 2012 and those pushing the tax remain hopeful that an FTT will be in place by the end of the year. France, Germany and Austria, have been the most vocal in bolstering an FTT, though several differences remain among these member states over what type of tax should be imposed and what the revenue should be used for.

On February 16, 2012, France announced that they adopted an FTT, which is scheduled to go into effect on August 1, 2012. While the details have not yet been finalized, the French "test tax" is expected to cover: (1) the purchase of securities; (2) naked sovereign Credit Default Swaps (CDSs); and (3) high frequency trades (HFTs). France has set the tax on securities at 0.2%, with two prerequisites to be met prior to the implementation of this tax. First, it only applies when a security is issued by a firm that is registered in France. Second, the firm must have a market capitalization exceeding one billion Euros on January 1 of the year of taxation. It is estimated that this includes approximately 150 firms. In addition, CDSs on sovereign debt and HFTs will have a 0.01% tax. The French Treasury has already issued guidelines on how this tax affects the purchase of securities, and it will also issue guidance on how this tax will affect CDSs and HFTs. Though the French "test tax" is only set at 10 basis points, banks are expressing concern about the tax and the fact that many details for this tax have not yet been finalized. European finance ministers would like an FTT to be in place by the end of the year, and are anxiously waiting for the financial sector's response to the

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French "test tax". In fact, on June 27, German Chancellor Angela Merkel said her Cabinet will ask the European Commission to initiate steps to facilitate a tax on financial transactions as well.

Chances of implementing an FTT in the United States seem much less probable at this point, though some have endorsed the idea as part of comprehensive tax reform process. A group of interested financial professionals circulated a petition promoting the FTT in June, 2012. The petition was signed by approximately 52 individuals, some of which are part of the financial sector. Additionally, Senator Tom Harkin (D-IA) and Representative Peter DeFazio (D-OR) introduced identical bills in the Senate and House in 2011 that would impose a STT on securities transactions at 3 basis points. The bills, S. 1787 and H.R. 3313 would raise $350 billion over 10 years according to Senator Harkin.

There is much economic and political controversy surrounding the tax. Supporters and opponents of the FTT have very different ideas of what an FTT would do to the United States economy. For example, proponents of the FTT argue that the average investor in individual stocks will not feel the impact of this kind of tax because a 0.03% tax on a securities transaction is almost nothing for an individual investor. Proponents also assert that the tax raises a significant amount of revenue and would actually decrease market volatility by stabilizing market prices and eliminating the adverse effects felt by the market due to high frequency trading.[1] Lastly, proponents argue that the most direct and immediate consequences of this tax would be felt by top income earners, thus increasing the progressivity of the tax system.[2]

On the other hand, critics of this tax point out that high-frequency trading, which is responsible for an estimated 50% of the volume on U.S. exchanges, would essentially end under any FTT because of the small margins on each trade.[3] This could mean that the Harkin/DeFazio bills might not be the deficit-reducing home run that they are hoping for.[4] Critics argue specifically that mutual funds and exchange traded funds would become almost impossible to trade and would likely disappear from the financial market and that an FTT may actually increase the volatility of the market by increasing the transaction cost and reducing the profitability of some trades.[5] **They say that because HFTs would leave the market, liquidity would dry up, which will cause the bid-ask spread to increase and could lead to higher volatility and lower security prices.** Critics argue that if the United States implements an FTT, unless it is applied globally, the tax will only result in a flow of investment away from the country, just as it did in Sweden in the 1980s when they imposed an FTT.

In 1984, Sweden introduced an FTT of 0.5% on the sale or purchase of an equity security traded with a local brokerage service. The 0.5% was later doubled to 1.0%, and a 0.002% tax on fixed-income securities was introduced, as well as a 0.003% tax on bonds with 5 year maturities. The day these taxes were announced, share prices fell by 2.2% and declined again when the tax was increased. During the first week of the tax, the volume of bond trading fell by 85%, and the volume

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[1] A Securities Transactions Tax: Brief Analytic Overview with Revenue Estimates, Keightley, Mark P., Congressional Research Service, Nov. 9, 2011

[2] Id.

[3] Financial Transactions Taxes In the United States, Scott, Jeremy, Tax Notes, May, 2012

[4] Id.

[5] New Dem Tax for Speculators Will Hurt Individual Investors**, Lehrer, Eli, Sept. 4, 2009**

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of futures trading fell by 98%, while the options market completely dried up. Trading volume moved to the U.K, and Swedish equity moved offshore. As a result of the vast decline in trading of all securities, the amount of revenue raised by the tax was far lower than Sweden anticipated. Critics fear that if the United States imposes an FTT, it will produce a similar market reaction to Sweden, which would be disastrous for the economy.

Lastly, critics of the FTT argue that the financial sector already pays its fair share on market trades. In 2010, President Obama signed the Conference Report for H.R. 4173, the "Dodd-Frank Wall Street Reform and Consumer Protection Act." Section 991 of the Dodd-Frank Act included amendments to the Securities Exchange Act of 1934 that would change the funding mechanisms for the SEC. The SEC is now entirely funded by Section 31 transaction fees. The Dodd-Frank Act also created an SEC Reserve Fund which is available for use by the SEC and funded by section 6(b) and 24(f) registration fees. The Act also modified fees pursuant to Sections 13(e) and 14(g) of the Securities Exchange Act of 1934, which are deposited and credited as general revenue for the Treasury. Ultimately, financial transactions are already charged a fee by the SEC and certain fees are reserved for the Treasury. If an FTT were implemented in the United States, it would impose a tax on these same transactions. In addition to the potential negative and volatile effects an FTT could have in the United States, it could also place a disproportionate burden on the financial sector, by levying a tax on transactions that have already paid a fee.

It is expected that the FTT will continue to grow in popularity as more European member states implement this kind of tax. Likewise, the need to raise revenue, coupled with the growing sentiment that the market should be regulated beyond the bounds of the Dodd-Frank Act and Basel III, could put U.S. financial markets in place for imposing an FTT.

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