



A SUMMARY OF

FINANCIAL TAXES

REPORT BY EMMA DAHL



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EXECUTIVE SUMMARY

Although the broad-reaching payments tax being proposed in the Financial Freedom Bill is unlike any other tax currently in place, the concept of taxing the financial sector is not new. This white paper offers a summary of selected financial taxes with the intent of highlighting the efficacy of such a tax. Taxes on the financial sector date back to as early as the 1600's, when England introduced their Stamp Duty Tax on legal instruments (which has since evolved into a tax on stocks). Many of these taxes have been implemented outside of the US and have been especially successful in smaller countries with financial structures that are nimbler than the US's legacy banking system. However, this isn't to say that such a tax wouldn't be successful in the US- in fact, the US's outdated and complex banking infrastructure is exactly why such a tax is necessary.

Financial taxes have been a popular market regulation mechanism used in Europe as a response to the 2008 global financial crash. In a recent report, the International Monetary Fund (IMF) stated that allowing countries' banking and finance sectors to grow more quickly than regulators can keep up with could lead to another crash ¹. In response to the 2008 crash, the European Union introduced a financial transactions tax to be applied on financial transactions between financial institutions. Although the tax was set to be approved in 2013, Brexit negotiations have delayed implementation. More narrowly defined taxes such

as that proposed by the EU face the added challenge of shifting financial markets. By taxing some, but not all, financial markets, the tax creates an incentive for investors to simply invest in a different financial product, rather than keeping their investments in place and paying the associated taxes.

While several of the financial taxes discussed below have been discontinued, their successes and failures offer a road map for how to develop a more robust tax to be implemented in the US. Notably, several of these discontinued taxes were introduced as being terminal and served short term budgetary purposes, such as raising revenues during financial crises. Taxes on financial transactions tend to range from 0.1- 0.5%, and the durability of these taxes is highly reliant on their design ². Whether these taxes can be deemed "good" or "bad" is dependent on what proportion of financial activity is unproductive and creates market volatility (rather than liquidity).

The below report is not a comprehensive list of financial transaction taxes but offers a snapshot of different approaches to taxing the financial sector and their relative successes.

TIMELINE

	1694	England: Stamp Duty Tax	
	1982 - 2002	Australia: Bank Accounts Debit Tax	
	1984 - 1992	Argentina: Bank Transactions Tax	
	1988	Colombia: Financial Transactions Tax	
	1999	Japan: Transaction Taxes	
	2004	India: Securities Transactions Tax	
	2012	France: Financial Transaction Tax	
	2016	China: Currency Transaction Tax	
	1914 - 1966	USA: Transfer Tax in Revenue Act	
	1984	Sweden: Equity Shares Tax	
	1993 - 2007	Brazil: CPMF Tax	
	1998	Taiwan: Stock Tax	
	2003	Peru: Foreign Currency Wire Tax	
	2009 - 2010	UK: Bank Payroll Tax	
	2012	Italy: Financial Transaction Tax	

COUNTRY PROFILES

ENGLAND STAMP DUTY TAX

Stamp duty taxes in England began in 1694 as a tax on legal instruments and have grown and evolved since then. In the 1700's and 1800's, England expanded stamp duty taxes to include purchases of everyday paper goods such as newspapers and playing cards. The tax was eventually grown to include a variety of non-paper items like cosmetics and hats because of its efficiency and ease in raising revenue. Stamp duty taxes on everyday items have since been phased out and is currently only levied on transfers of stocks and securities, issuance of bearer bonds, and certain partnership transactions.

In the Financial Act 1986, England introduced the Stamp Duty Reserve Tax (SDRT) which now applies to the transfer of most shares and securities. The SDRT isn't a traditional stamp tax and is instead collected by participants such as brokers when a transaction takes place. The SDRT rate is 0.5% except for people who run depository receipt schemes and clearance services other than the primary clearing service used in the UK. For these categories, a rate of 1.5% is applied and is paid almost entirely by foreign investors.

USA TRANSFER TAX IN 1914 REVENUE ACT

The US Revenue Act of 1914 was built of four different tax bases, one of which was a series of special taxes on tobacco, bankers, brokers, commission merchants, and proprietors of public amenities. The act was set to expire in December of 1915 but was bringing in a substantial enough portion of taxes that congress extended it till December 1916. When the government realized that they would need more reserves to finance war, they expanded the taxes in the War Revenue act of 1917. The taxes on transactions in the Revenue Act were phased out in 1966. The bill included a 0.1% tax on financial transactions made by bankers as well as a variety of other low rate taxes on financial products. The US also currently funds the Securities and Exchange Commission with a low rate tax on securities transfers.

AUSTRALIA BANK ACCOUNTS DEBIT TAX

The Australian Bank Accounts Debit Tax was a tax levied on consumer withdrawals from bank accounts with a check facility, first implemented in 1982. The tax depended on amount withdrawn but varied from \$0.15 to \$4.00 (prices given in Australian dollars). The tax was repealed between 2002-2005 (dates varied by state) and was replaced with a broader Goods and Services Tax. While there is little information available on this tax, news articles at the time suggests that consumers were unhappy with paying a relatively high rate for depositing into their accounts.

SWEDEN EQUITY SHARES TAX

The 1984 Swedish Financial Transaction Tax introduced a 0.5% tax on the sell or purchase of equity shares. The intention of the tax was to improve market efficiency and reduce speculation. The tax rate was doubled to 1% in 1986, and the base was broadened to include share options and convertibles. In 1989 a 0.002% tax on fixed income securities were introduced, as well as another base-broadening measure to include bonds under the 1% tax. This tax has widely been considered unsuccessful because the limited scope created an incentive to simply invest in alternate financial products which heavily reduced expected revenue. Average turnover for stocks decreased by 30% in the immediate aftermath of the increase to 1% and turnover for the 11 most traded shares decreased by 60%. The inclusion of bonds in 1989 led to an 85% reduction in bond trading as well.

Some derivatives and debt instruments were excluded from the tax, and when other investment vehicles became comparatively expensive, investment in derivatives and debt skyrocketed. By taxing some, but not all, financial products, the Swedish equity shares tax reduced market liquidity but kept volatility high. An example of the policies that led to this volatility was the varying rate applied to bonds of different maturities. While bonds with maturities over 5 years were taxed at a rate of 0.015%, those under 90 days were taxed at 0.001%. Lower rates on shorter term products led to an overall reduction in trade but a tendency towards shorter term products which created market instability.



ARGENTINA BANK TRANSACTIONS TAX

Argentina levied a 0.6% Bank Transactions Tax (BTT) between 1984- 1992. This tax was levied during a financial crisis on credits and debits in banking accounts. At the time, tax revenues were declining sharply due to hyperinflation, evasion, and slowed economic activity³. Taxing deposits into bank accounts had the long run impact of reducing deposits by around 3% per each 0.1% increase in the tax rate. The goal of the tax was to raise a large amount of revenue in a short period of time and was eliminated once the required revenue was raised. Several other South American countries have also implemented, and then eliminated, similar taxes during financial crises as a mechanism to quickly raise revenues. The bank transaction tax was reintroduced briefly in 2001 but was removed again within the year. Similar to other geographically small countries (at least in comparison to the US) one of the issues faced with this tax was that Argentines would simply open bank accounts in Uruguay to avoid paying the tax.



BRAZIL CPMF TAX

The Brazilian CPMF tax was a 0.38% tax on bank account withdrawals implemented in 1993 with the intent of funding healthcare. The functions of the tax were to increase revenue and reduce speculative and short-term investments. The CPMF model was essentially evasion-proof and was more efficient and less costly than other taxes that had been implemented in Brazil. Additionally, the Brazilian CPMF was more successful than similar taxes implemented in other South American countries and was able to sustain a higher revenue yield with less deadweight loss³. It also proved to be essentially evasion-proof for two reasons. Firstly, avoiding the tax meant not owning a bank account (inconvenient at the least), and tracking the flow of money through bank accounts helped signal underreporting on income. The tax was eliminated in 2007, supposedly by corrupt politicians attempting to hide their money dealings.



COLOMBIA FINANCIAL TRANSACTIONS TAX

In 1998, Colombia implemented a 0.2% tax on all financial transactions. This included internet banking, deposits, currency exchanges, checks, and loans. It also taxes all transactions that result in funds being transferred outside of Colombia. The tax is still in place and the rate has been raised to 0.4%. Similar to the Argentine BTT, the Colombian FTT was implemented during a financial crisis with the purpose of saving the finance sector. While the Colombian tax has lasted beyond the financial crisis, it is slowly being phased out, to be removed entirely by 2022. The initial tax implemented in 1998 was estimated to cause up to 40% deadweight loss, and also reduced the volume of cleared checks by half ³. However, after the initial adjustment period, the tax was seen as an important source of revenue for Colombia and made up 0.8% of GDP ⁴. An important consideration to draw from the Colombian financial transaction tax is that for some industries that used the banking system to facilitate transactions, the tax cascaded and was paid several times over. The Colombian financial transaction tax also created an incentive for people to avoid the tax by using cash instead.



TAIWAN STOCK TAX

Since 1998, Taiwan has levied a 0.01-0.06% tax on stock index futures. The tax rate is higher for company issued stocks than bonds and other government-approved securities. A reduction of the stock index futures tax in 2000 indicated that changing the tax rate on stocks does not impact price volatility but does reduce trading volume. Additionally, the 50% tax rate reduction in 2000 led to only a 13% reduction in tax revenue, and like several south American countries, there was a significant rebound in tax revenue in the years following the initial rate adjustment ⁵. In 2009, this tax raised around \$2.69 billion, or around 0.8% of GDP. Taiwan also has a Securities Transaction Tax (STT), which is implemented at the rate of 0.3% for company shares and 0.1% for bonds and other securities.



JAPAN TRANSACTION TAXES

Until 1999, Japan had widespread taxation on the financial sector. Taxes were levied on a variety of financial products such as debt and equity instruments. The tax was efficient at collecting revenue and brought in around \$12 billion per year but was eliminated in 1999 as part of a larger rollback on financial regulation. These financial rollbacks were seen as unfinished and ineffective given (1) that the rest of the Japanese economy did not experience a simultaneous deregulation and (2) that the Japanese are generally risk-averse, stifling the potential of the rollbacks. The 1991 Japanese market crash and following 10 years are often referred to as the “lost decade” given the unprecedented wage (13%) and GDP (18%) falls. The Japanese market crash was compounded by both the larger Asian market crash in ‘97-‘98, and denial of the crash on the part of Japanese government officials. Although the Japanese financial sector taxes were rolled back during this period, they weren’t responsible for the crash- the crash was the result of widespread mismanagement of both fiscal and monetary policy in the aftermath of the 1989 Japanese housing crash.



PERU FOREIGN CURRENCY WIRE TAX

In 2003, Peru implemented a 0.3% tax on foreign currency wire transactions. The goal of the tax is to raise funds for education. Peru also levies a financial transaction tax of 0.005% on debit and credit transactions from Peruvian bank accounts. The tax exempts transfers between accounts of the same holder, salary deposits, and transfers of both diplomats and international organizations in Peru. This financial transaction tax is included in a more broad-reaching value-added tax (VAT). As a side note, Peruvian law also adds that payments made in cash are exempt for tax purposes (expenses, tax recovery, etc.).



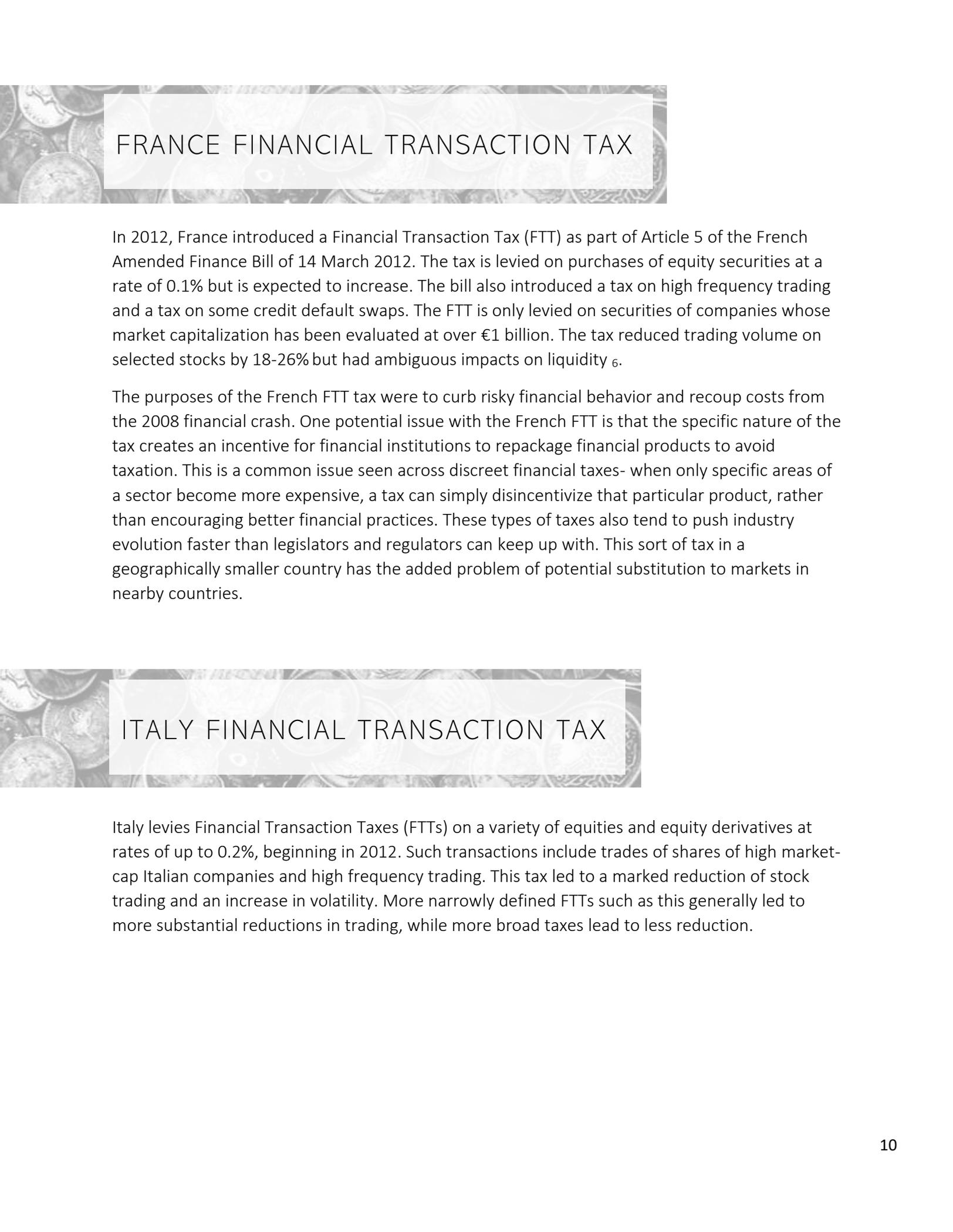
INDIA SECURITIES TRANSACTION TAX

In 2004, India levied a series of Securities Transaction Taxes (STTs) up to 0.135% on securities transactions processed through a national stock exchange. The tax doesn't apply to off-market transactions or trades in currencies and commodities. In 2013, the tax was reduced because of protests from the brokerage and trading community. In the 2017-2018 year, the STT brought in 43% more revenue than estimated. This increase is mostly due to high turnover in derivatives trading. The STT was introduced in India to prevent evasion of the capital gains tax by intersecting profits during transactions.



UK BANK PAYROLL TAX

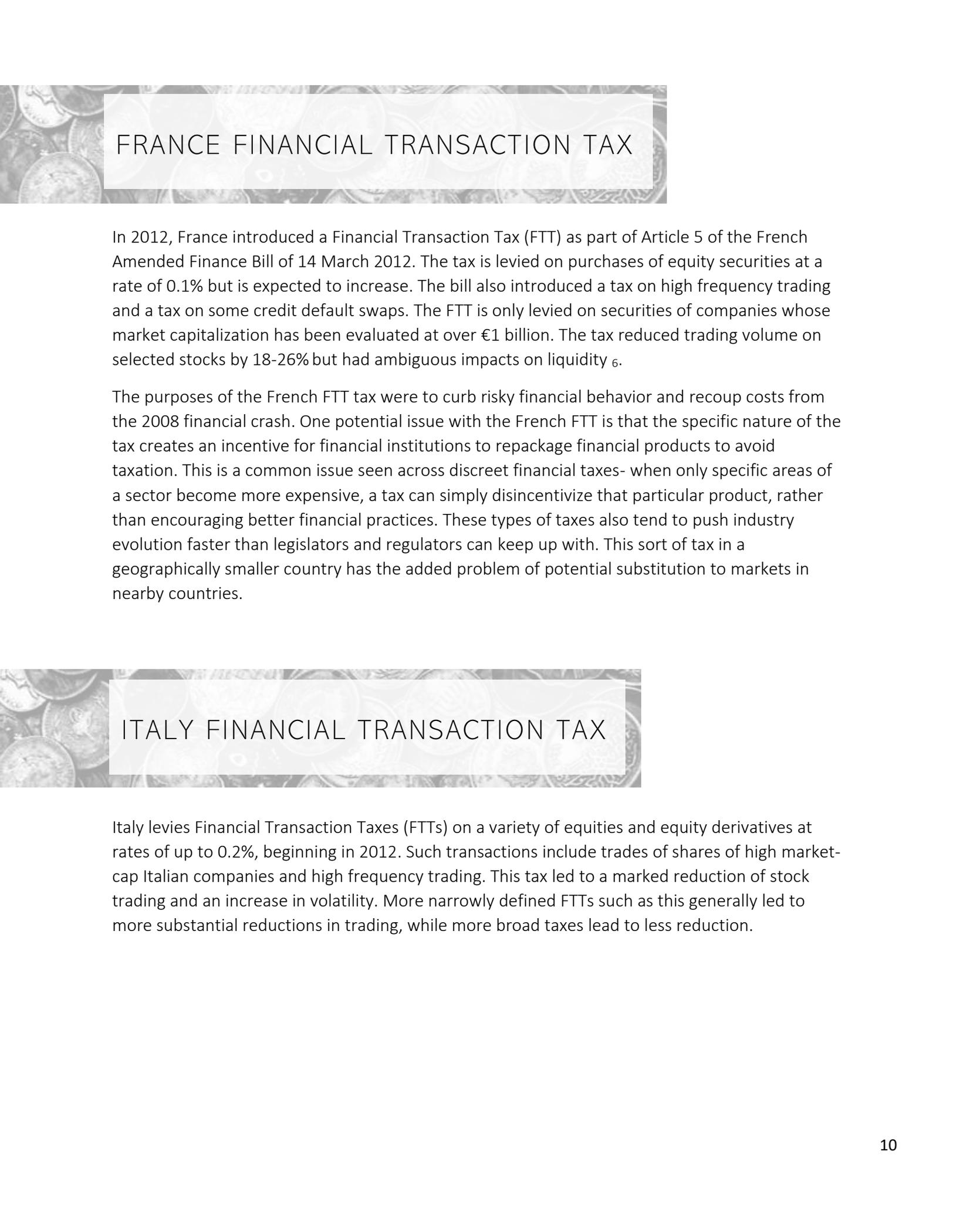
In 2009, the UK introduced a new tax on bankers who receive commissions over 25,000 pounds. The bank payroll tax was a one-off tax that was only implemented between December of 2009 and April of 2010. The tax was at a rate of 50%. While the UK Bank Payroll Tax wasn't a direct tax on finance, it was a tax on the finance sector. This tax was in part due to public perceptions of the banking sector in the wake of the global financial crash. While the tax raised substantial funds, its implementation was more due to blowback from the crash than its use as a tax instrument. Employees who were impacted by the tax were mostly high-level bankers who dealt with lending and investment for banks. Taxing bonuses with one-off legislation raised concerns that banks might either temporarily increase base pay to retain high level staff or defer bonuses until the legislation expired.



FRANCE FINANCIAL TRANSACTION TAX

In 2012, France introduced a Financial Transaction Tax (FTT) as part of Article 5 of the French Amended Finance Bill of 14 March 2012. The tax is levied on purchases of equity securities at a rate of 0.1% but is expected to increase. The bill also introduced a tax on high frequency trading and a tax on some credit default swaps. The FTT is only levied on securities of companies whose market capitalization has been evaluated at over €1 billion. The tax reduced trading volume on selected stocks by 18-26% but had ambiguous impacts on liquidity ⁶.

The purposes of the French FTT tax were to curb risky financial behavior and recoup costs from the 2008 financial crash. One potential issue with the French FTT is that the specific nature of the tax creates an incentive for financial institutions to repackage financial products to avoid taxation. This is a common issue seen across discreet financial taxes- when only specific areas of a sector become more expensive, a tax can simply disincentivize that particular product, rather than encouraging better financial practices. These types of taxes also tend to push industry evolution faster than legislators and regulators can keep up with. This sort of tax in a geographically smaller country has the added problem of potential substitution to markets in nearby countries.



ITALY FINANCIAL TRANSACTION TAX

Italy levies Financial Transaction Taxes (FTTs) on a variety of equities and equity derivatives at rates of up to 0.2%, beginning in 2012. Such transactions include trades of shares of high market-cap Italian companies and high frequency trading. This tax led to a marked reduction of stock trading and an increase in volatility. More narrowly defined FTTs such as this generally led to more substantial reductions in trading, while more broad taxes lead to less reduction.



CHINA CURRENCY TRANSACTION TAX

In 2016, China drafted legislation to tax foreign currency transactions. While the legislation stated an initial tax rate of 0%, the goal of the legislation was to curb shorting of the Yuan. The 0% tax rate will supposedly only be increased in the case of heightened speculation of the Yuan. This type of currency tax is an example of the tax first proposed by James Tobin in the 1970's. The goal of such a tax is to slow short-term currency exchange and dissuade speculative currency investment without impacting more long-term investments. Although this legislation hasn't been enacted yet, economists expect that a tax on foreign currency transactions will have unintended side effects.

CONCLUSION and bio

Taxes on the financial sector are not uncommon and have been implemented in countries around the world. The success of these taxes is highly dependent on the specific design of the tax and the geopolitics of the country. Countries such as England and Brazil have been able to successfully implement FTTs without causing disruption to their financial markets. Taxes such as these tend to be at a low rate and are applied across a broad base of financial products. This creates less incentive for individuals to evade the tax by either substituting to a different financial product or moving their money out of the country. The US did have an FTT levied in the early 1900's to help finance the first world war, and eventually phased out the tax in the 1960's.

FTTs are commonly implemented during financial crises as a way for governments to quickly raise revenue- these types of FTTs are generally terminal in nature and, while effective at raising revenue, also have a heavier impact on financial markets given their higher rates. During the 70's- 90's, many South American countries used these policies to help recover from recessions. When looking at impacts on markets, financial taxes tend to create an initial market shock- trading volume decreases markedly which leads to deadweight loss and lower tax revenue than anticipated. However, studies on the impacts of these taxes indicate that these negative indicators decrease after the shock passes.

While this report isn't a comprehensive picture of all taxes on financial sectors, it offers a snapshot of why some of these taxes have succeeded or failed. The success of tax policy, like most policies, depends on the specific economic and geopolitical conditions of a country, and can rarely be copy-pasted from one country to the next and deliver the same results. A tax that succeeded in Taiwan could be disastrous in the US, and vice versa. Although policy can feel inaccessible when overly technical, it is the details that will determine its ability to catalyze change.



bio

Emma has worked as an analyst for the Financial Freedom Bill for the past two years. In addition to writing reports, she produces other supportive research and, on occasion, performs miracles. She holds a BA in Economics from Colorado State University and will pursue a master's in Business Analytics and Big Data in the fall at IE Madrid. In her free time, she enjoys dancing salsa and traveling.

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