THE FINANCIAL TRANSACTION TAX: IMPLEMENTATION AND AVOIDANCE

The financial transaction tax can be defined as a tax on the purchase, sell and transfer of financial products.

There are various types of financial transactions tax: its tax base can include the financial instruments of foreign exchange markets (currency transaction tax), of stock markets (securities transaction tax) or of all the segments of the financial markets (financial transaction tax) and it can be levied on the transfer of property of these assets (stamp duty) or on the execution of financial transactions.

Despite the fact that in some countries this tax is in force since the end of the XIX century, John Maynard Keynes was the first to propose its implementation for regulating the financial markets, namely the American stock market, in 1936. In 1972 and in 1978, James Tobin stated that a currency transactions tax could be used to contain the speculation in the foreign exchange markets.

The subprime mortgage crisis has made the governments and citizens concentrate again on this topic.

The purpose of this essay is to analyse the European Commission's proposals for a financial transaction tax, focusing on their exposure to avoidance.

To be more precise, firstly, the aim is to examine the process which has led to the idea of implementing a financial transaction tax in the European Union and the role that the problem of avoidance has had in determining the different positions on that. Secondly, attempts have been made to evaluate how much the Commission's proposals for a financial transaction tax in the European Union (28 September 2011) and in eleven Member States (14 February 2013) are susceptible to tax avoidance.

This thesis is structured as follows: the first chapter concerns the negotiations that have led from the idea of adopting a financial transaction tax globally to the possibility of its introduction in the European Union and, then, in eleven Member States. It is important to reconstruct the stages of this process because the problem of avoidance arises when moving from the global level to the regional one and because the exposure of this tax to avoidance has been one of the reason behind opposition of the International Monetary Fund and, initially, of the European Commission to its adoption.

The second chapter deals with the main avoidance strategies, namely the avoidance through the transfer of transactions to offshore markets and the avoidance through the migrations of trades to untaxed financial products. For each form of tax avoidance, two prime examples have been singled out, in order to demonstrate how market participants can actually avoid financial transaction taxes and so as to better understand on which bases the European Commission has designed its proposals and why they have been criticized. Finally, it has been analyzed the financial transaction tax proposed by the European Commission in 2011 and in 2013.

The subprime mortgage crisis, which exploded in the United States in 2007, spread, by virtue of the globalized finance, to the European Union and to the rest of the world in 2008.

In order to save the domestic banking systems, the governments were forced to intervene.

According to Laeven and Valencia (2012), since 2007 for the United States and the United Kingdom and since 2008 for the States of the Eurozone, the output losses have amounted to 23% for the States of the Eurozone, to 25% for the United Kingdom and to 31% for the United States. For saving the domestic financial sector, the resources used have been equal to 3,9% of GDP in the States of the Eurozone, to 8,8% of GDP in United Kingdom and to 4,5% of GDP in the United Sates.

In 2009, there was a negative growth rate of the GDP in the Eurozone (- 4,4%), in United Kingdom (-4,0%) and in the United States (-3,1%) (OECD 2009).

In this context of recession and shortage of resources, the awareness that this was the result of the financial deregulation and of the financial speculation persuaded the governments to try taking measure to strengthen the financial supervision and to made the financial markets pay the costs of the crisis.

In the international forum, the governments begun discussing about the implementation of a financial transaction tax that could limit the speculation on financial markets and raise revenues.

In September 2009, at the G-20 summit in Pittsburgh, the International Monetary Fund was requested to find how the financial sector can bankroll the recovery. The European Council, in December 2009, and the European Parliament, in February 2010, exhorted the European Commission to analyse how a financial transaction tax could be implemented in the European Union.

In 2010, the International Monetary Fund and the European Commission published their first studies on this topic.

In “A Fair and Substantial Contribution by the Financial Sector” (IMF, 2010a), the International Monetary Fund stated that the financial transaction tax could not be used as a stabilisation tool and as a source of revenue. Because of the absence of a correlation between transaction cost and the formation of speculative bubbles, the financial transaction tax would have not improve the efficiency and the equilibrium of the financial markets, even if it had made these costs increase. Moreover, according to the International Monetary Fund, this tax would have been particularly susceptible to avoidance, namely to avoidance by integration, by financial engineering and by relocation of trades in offshore markets.

Similarly, in the studies “Innovative Financing at a Global Level” (European Commission, 2010a) and “Financial Sector Taxation” (European Commission, 2010b), the European Commission affirmed that the financial transaction tax would have augmented the cost of capital for governments and companies and that the market participants would have easily avoided it, transferring their investments in other financial centres and trading untaxed financial instruments.

Both the International Monetary Fund and the European Commission said that a financial transaction tax could be successfully implemented only at a global level.

After the failure of the negotiations between the G20 leaders in June 2010, despite the Commission’s opposition to the introduction of a financial transaction tax at a regional level, in March 2011 the European Parliament adopted a resolution that compelled the Commission to design a financial transaction tax that could be implemented in the European Union.

On 28 September 2011 the European Commission published the communication “Proposal for a Council Directive on a Common System of Financial Transaction Tax and Amending Directive 2008/7/CE”.

As it has been stated before, up to the adoption of the European Parliament resolution in March 2011, the European Commission had a unfavourable opinion of the financial transaction tax, chiefly because of its exposure to avoidance. In the proposal for a Council directive of September 2011 (European Commission, 2011a) and in its Impact Assessment (European Commission, 2011b), the perspective was completely overturned: the European Commission stated that the problem of avoidance and the consequent distortion of the level playing field between the European financial centres were the elements that legitimised the European Union action in the area of financial sector taxation and decided to go ahead with the introduction of a financial transaction tax in order to demonstrate its feasibility and to foster its implementation at global level.

It is important to note that the distortion of competition in the internal market was the direct result of the unilateral introduction of financial transaction taxes by some Member States. According to the European Commission, these national measures could have caused the occurrence of double taxation and the development of tax heavens also in the European Union (European Commission, 2011a; 2011b).

Before analysing the European Commission’s proposal, it is necessary to point out that, in the impact assessment, two taxes were compared - namely the financial transaction tax (FTT) and the financial activities tax (FAT) - and that the Commission established that it was easier, for the market participants, to avoid the financial transaction tax. In spite of this, the European Commission proposed its introduction because it thought that the exposure to avoidance of this tax would have substantially diminished if other countries had decided to adopt it and because of the "political and economic value" (European Commission, 2011b: 38) of being the first to implement successfully such a type of tax.

According to the proposal of the European Commission, the European financial transaction tax - or, to be more precise, the financial transaction tax that the Member States should have conformed the domestic fiscal system to - would have been levied on the sell, purchase and transfer of financial products - both on the exchange markets and on the over-the-counter markets - and on the "conclusion or modification of derivatives agreements" (art. 2 par. 1 point 1) lett. c)). The tax base, in accordance with Section C Annex I of MiFID directive, would have been constituted by the financial instruments of the money market and of the capital market, by the derivatives - the foreign exchange derivatives included -, by the repurchase agreements and the reverse repurchase agreements and by the units and shares of undertakings for collective investment in transferable securities and by "other financial instruments offered by way of a securitisation" (art. 2 par. 1 point 6). The European financial transaction tax would not have been applied on the issuance of securities and, in general, on the primary market. The tax rate would have been equal to 0,1% for the instruments of the exchange markets and to 0,01% for the instruments of the over-the-counter markets. The financial institutions would have been the taxable persons.

As far as the territorial coverage's concerned, the European Commission's proposal would have been based on the residence principle, this means that the European financial transaction tax would have been levied on the transactions executed by European financial institutions. To be more precise, the European financial transaction tax would have been imposed on the trades of those financial transactions that have a branch or the headquarter in a Member States, or that are defined as resident financial institution by the national authorities or that trade with a resident financial institution.

As regards the avoidance through the migration of transactions to untaxed products, even those who opposed the introduction of such a tax, acknowledged that the probabilities of avoidance would have been minimal because of the large tax base (Shaviro, 2012; Vella, Fuest and Schmidt-Eisenlohr, 2012).

The exposure of the European financial transaction tax to avoidance by financial engineering would have been limited even in the long term if it had been possible to update the tax base periodically, so as to tax also the new financial products that could be created for replacing the taxed ones (Brondolo, 2011).

In connection with the avoidance through the migration of transaction in untaxed financial markets, the European Commission tried containing it by applying the above-mentioned residence principle.
According to Vella, Fuest and Schmidt-Eisenlohr (2012), it would have been possible to avoid the European financial transaction tax by executing the transactions through subsidiaries which are not resident in the territory of the European Union.
Nevertheless, the researchers may have not considered that the European Commission was aware of the existence of this avoidance strategy and of the possibility that the European financial institutions could transfer their headquarters in other countries, but that it deemed it unlikely because it would have brought about the loss of the European costumer base (European Commission, 2011c).
Moreover, the European Commission (2011f) thought that the choice where to trade depended not only on the transaction cost, but also on other factors, for instance the political stability and the existence of network externalities.
In accordance with art. 17 of the proposal for a Council directive, the European financial transaction tax would have come into force in January 2014.
However, the Member States did not reach agreement to the European Commission's proposal.
Some Member States, most notably United Kingdom (which impose a tax on the transfer of financial instruments issued by British companies on the exchange market) and Sweden (which introduced a securities transaction tax in 1984 and was forced to revoke it because market of market participants easily avoided it), objected to the implementation of this tax at a European level since they thought that it could jeopardise the competitiveness of the European financial markets (Richard, 2013).
In May 2012, the European Parliament adopted a resolution where it requested that the European Commission strengthened the residence principle and hence that the issuance principle was introduced. It also stated that the recognition of the transfer of property should have been subordinated to the payment of the tax. According to the European Parliament, these amendments were necessary to reduce the likelihood of tax avoidance and so, presumably, to make the above-mentioned governments revise their opinions (European Parliament, 2012b).
In spite of this, the negotiations between the Member States failed.
In November 2009, eleven Member States, namely Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain, affirmed that they wanted to implement the financial transaction tax through the enhanced cooperation procedure (ECOFIN, 2012c).
After having obtained the consent of the Council and of the European Parliament, on 14 February 2013 the European Commission published the communication "Proposal for a Council directive

implementing enhanced cooperation in the area of financial transaction tax" (European Commission, 2013a).

One of the main modifications made to the original proposal is the introduction of the issuance principle, as request by the European Parliament. With this principle, the financial transaction tax is levied also on the transactions that concern financial instruments issued by companies which are resident in one of the Member States that participate to the enhanced cooperation procedure (even if they are executed by foreign financial institutions) (art. 4 par. 1 lett. g)).

It is important to note that the fact that only eleven Member States will implement the financial transaction tax can make another avoidance strategy possible. In fact, as the European Commission has admitted, the financial institutions established in one of the Member States that participate to the enhanced cooperation procedure can easily avoid the tax by moving to untaxed European countries or by transforming the branches in subsidiaries (European Commission, 2013b).

As a result, the financial transaction tax designed in the second proposal is presumably more exposed to avoidance.

As regards the avoidance through financial engineering, as pointed out by Englisch, Vella and Yevgenyeva (2013), in the proposal of February 2013, the Commission stated that the depositary receipts should be included in the tax base if they are used to avoid the tax.

In brief, in this thesis attempts have been made to understand how much the financial transaction taxes designed by the European Commission in September 2011 and in February 2013 are exposed to tax avoidance.

It is important to note that, as regards the first chapter, this thesis has limited itself to the appeals to the implementation of a financial transaction tax subsequent the financial crisis of 2007 and that, as far as the second chapter's concerned, the strategies whereby a currency transaction tax can be avoided have not been analysed because the transactions of the spot foreign exchange markets are not included in the tax base.