# Feasibility study of a European financial transaction tax
# Main conclusions

This paper from the Greens/EFA group in the European Parliament defines the technical and legal conditions for the implementation of a financial transaction tax (FTT) at EU level or, alternatively, as a first step within the Eurozone. The paper makes clear that a European FTT with a tailor made scope is feasible technically and legally, would raise substantial revenues and contribute to reducing harmful short-term speculation. The main conclusions of the study are as follows:

**Generating up to €190 billion per year**
Introducing a levy at a tiny rate of 0.05% on the face value of transactions across the European Union could raise **up to €190 billion per year** - €80-190 billion depending on different assumptions (see annex). In addition, a FTT would have very limited impacts on households and companies as the tax burden would overwhelmingly fall on the financial industry and wealthy individuals. It is an ideal instrument for increasing public revenues without impacting on consumption or investment. A European FTT could thus be an innovative solution to the fiscal problems of the EU and its member states, as well as helping to finance Europe's global commitments, such as in development or climate change.

**Reducing damaging financial activities**
A financial transaction tax would act as a direct disincentive to short-term speculative trading, making it unprofitable. Given the serious damage short-term speculative trading can cause, reducing this risky activity would leave the financial system less exposed to volatility and more efficient. A FTT would also eliminate the systemic risks associated with high-frequency trading (such as the US 'flash crash' of 6 May 2010).

**Europe can implement an FTT alone**
In the absence of a global financial transaction tax, a European FTT should and could be introduced and generate substantial revenue. Drawing lessons from unsuccessful attempts at introducing an FTT, such as in Sweden in the late 1980s, but also very successful FTT regimes, such as in the UK or in Switzerland, our paper designs a European FTT where the risk of circumvention is very low and which maintains a level-playing field between European financial actors and their foreign competitors. Furthermore, a commitment of the EU to a FTT regime could change the nature of the debate on a global FTT.

**A European FTT - scope and issues**
A European FTT could cover most of the financial transactions at EU level: transactions of European stocks and bonds, interest rate derivatives on European currencies, the purchase of equity derivatives on European stocks and credit derivatives by European users, as well as foreign exchange currency transactions within the EU could be taxed. These markets have the common feature of being linked either to European trading venues or to a European currency. Clearly, some products could not be taxed for legal reasons, notably those involving non-EU

transactions: foreign currency foreign exchange derivatives as well as Commodity derivatives. These are “global products”, and their taxation in Europe would simply lead to a transfer of the trading of these products to non-taxed areas. Tax exemptions for non-financial users of derivative products could be envisioned in order ensure as high a revenue as possible could be generated.

**A Eurozone FTT - scope and issues**

As some non-Eurozone member states, mainly the UK and Sweden, are clearly reluctant to introduce a financial transaction tax, the paper also analyses the introduction of a Eurozone FTT. In order to avoid major circumvention of the FTT, the implementation of a Eurozone FTT would require the cooperation of non- Eurozone member states in order to ensure the taxation of all financial products linked to the Euro currency. For example, trading in the UK of Euro denominated financial products should be taxed with some share of the tax revenue going to the benefit of the UK Treasury. Clearly, the revenue generated would be lower than an EU-level tax: a Eurozone FTT of 0.05% could generate €41-98 billion per year, covering all transactions of Euro-related financial products (equity, bonds, interest rate derivatives etc).

**European FTT - easy to levy**

The levying of a FTT does not pose any technical difficulty as all taxed financial transactions in Europe will be either centrally settled or at least centrally recorded, as stipulated in new EU legislation. The tax could be levied cheaply on settlement of the transactions via payment and settlement systems operated by regulated and organised markets, as is the case with Stamp Duty (on shares and securities) in the UK for example. As for over-the-counter transactions that are not settled by payment and settlement systems, the FTT would be levied by the tax collecting authority on the notification of European central security depositories (for stocks and bonds) and European trade repositories (for derivatives), which according to new EU legislation (EMIR Directive, published by the Commission on the 15th September 2010) will record all over-the-counter transactions. Similar steps have already been taken in the US with the adoption of the Wall Street reform bill.

**Legal feasibility**

The introduction of an EU-wide FTT is in line with EU and international law. Based on Article 113 TFEU the European Council, can after consultation of the Parliament and the Social and Economic Committee, pass legislation in order to harmonise national indirect taxation legislation. Similar to rules on VAT, minimum harmonisation for broad FTTs can also be agreed upon. A properly-designed EU FTT would be in line with the general principles of free movement (i.e. *free movement of capital*). Potential distortions to the free movement of capital can be justified on grounds of public interest. The same is true for potential conflicts with international agreements such as the GATS. An eventual Eurozone FTT could be implemented on the basis of Article 20 Treaty of the European Union.

**Review**

It will be necessary to measure the impact and effectiveness, and it would be logical to review the situation 5 years after the implementation. This review should be based on an in-depth analysis of the effects of the FTT on such economic variables as market volatility, market liquidity, revenue and financing cost of companies.

# FAQ:

**Will payments be taxed as well?**
Payments between households and enterprises would not be taxed, neither would transactions between financial institutions and their clients do not fall under the scope of the tax. The FTT only applies to transactions between financial institutions (brokers, banks) on the financial market.

**What are the precedents and what implications can be drawn?**
First of all, the concept of an FTT is not at all new and FTT's exist already in numerous countries, such as the UK, Switzerland, India. Secondly, tax regimes also have to adapt to the changing nature of our economies. Value Added Tax was a French invention implemented for the first time 1954. Not all consequences, positive or negative, of VAT on other economic variables were known before its implementation. Today, however, practically every country of the world uses this tool raising taxes.

**Why not introduce a European FTT on the model of the UK Stamp Duty?**
A European "UK style" Stamp Duty (on shares and securities) would not raise significant revenue because brokers and market makers are exempted from the tax. These are exactly the actors that are engaging in the great majority of financial transactions.

**Is there a risk that a European FTT would neither raise significant revenue nor reduce harmful speculative transactions, because trading activities would move elsewhere as occurred in Sweden?**
The Swedish FTT is a good example of a badly designed FTT. Swedish brokers and banks were responsible for levying the tax. Swedish investors hence could easily circumvent the tax by using foreign brokers. This example proves that a FTT need to be carefully designed in order to be effective and therefore efficient.

In contrast to the Swedish FTT, the proposed EU or Eurozone FTT should generate sufficient revenue and be difficult to circumvent, as the transaction volumes in the EU as well as the Eurozone are of a sufficient size to allow for the implementation of a broad based FTT, which prevents circumvention of the tax by trading in substitute products. A European tax would be levied at the point of settlement by the payment and settlement systems and on information from the trade repositories and centralised securities depositaries (CSD). Dissuasive exit taxes could prevent the development of parallel secondary market outside of the FTT area.

In order to make a Eurozone FTT watertight, however, a deal would have to be found whereby exchanges and financial institutions engaging in regulated or over-the-counter (OTC) transactions related to stocks and bonds held by euro-zone CSD's would be taxed by non-Eurozone EU member states as well. Revenues from the tax would be split between the Eurozone member states and the non-Eurozone tax collecting EU member states.

**Will the consumer not ultimately bear the cost of the FTT as it is passed through, thus negatively effecting the real economy by increasing the financing costs of European economies?**
The FTT is unlikely to have a significant impact on the financing cost of companies. Indeed a low rate FTT would mainly impact short-term transactions and be largely insignificant for long-term financing. Nevertheless, it is clear that part of the tax burden would be passed on to the financial institutions' customers. The incidence of an FTT would, however, be very progressive. An IMF working paper clearly establishes that there is a strong link between an

individual's wealth and the amount of financial assets he holds and trades. Moreover, an FTT would also be paid on property trading made by financial institutions.

**Is there a risk that the introduction of a FTT would increase the volatility of markets?**
It depends on how you define volatility. If you consider short term volatility (differences of prices between two successive trades), a FTT could logically increase the volatility. The spread between bid and ask will probably be more important as the transaction costs will be higher. However, this very short term volatility of prices is not the real question as it can only be a problem for short term investors. On a more long term basis, it is noticeable that the reduction of transaction costs during the last 20 years has not led to any reduction of the fundamental volatility of financial markets. Bubbles are inherent to unregulated markets regardless of the transactions costs. There have been bubbles in stock markets with very low transactions costs just as there have been in real estate markets with very high ones. A FTT is also unlikely to have a negative impact on this long term volatility of markets.

**Why not consider a financial activities tax (FAT) as an alternative to a FTT?**
A Financial Activities Tax (FAT) is a very new concept that has barely been implemented up to now. FTTs already exist in numerous jurisdictions on the other hand. Furthermore, the Commission and IMF proposals for a FAT are very ambiguous and lack clarity. There are no clear proposals on how to levy an FAT, how much revenue it would generate and in what way it would have to be constructed to restrict harmful speculative trading. There are much more open questions regarding a FAT than a FTT. The proposal for an FAT seems to be more a diversion tactic than a serious alternative to FTT.

**Given bank levies and new Basel capital rules already make banking more expensive, would an additional tax not be overkill?**
Firstly, it has to be noted that no VAT is levied currently on the products sold by the financial sector industry. In respect to other industries, the financial sector is hence already under-taxed. A European FTT has to be seen as a complementary tool to bank levies and the Basel III capital rules, which on the one hand try to make sure that banks are more robust in the face of sudden market downturns and that the financial sector takes over a greater part of the costs of a future financial crisis. An FTT instead targets speculative traders, regardless whether they are banks or hedge funds, and thereby directly reduces the likelihood of the formation of new financial bubbles.

**What would be the legal basis for a EU FTT and what is the procedure to implement it on European level?**
The legislation will have to be based on Art. 113 TFEU on which basis the European Council can, after consultation of the European Parliament and the Social and Economic Committee, pass legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.

**Is a European FTT in line with the *free movement of capital*?**
This general principle established in the Treaties (Art. 63 TFEU) and consequently further developed in the case law of the European Court of Justice (ECJ) prohibits all restrictions on the movement of capital. No EU regulation can bet in conflict with this concept. Nonetheless, it has to be considered that the free movement principles are not absolute freedoms. The adoption of legislative measures potentially impeding the free movement provisions can be justified on grounds of public interest[1].

[1] In *Case 203/80, Casti* the ECJ recognises public policy as a permissible restriction to capital movements. It is

The intention of the FTT to be an instrument stabilising the (European) financial markets certainly has to be considered a public interest. A general FTT would be able to ensure several objectives. On the one hand it would stabilise financial markets by reducing the volume of speculative high-frequent transactions and on the other hand generate additional revenue helping member states to limit deficits. No other known measure would have this similar double effect while at the same time being less interfering with the free movement provisions and non-discriminating.

**Would an EU FTT be in line with international law (GATS)?**

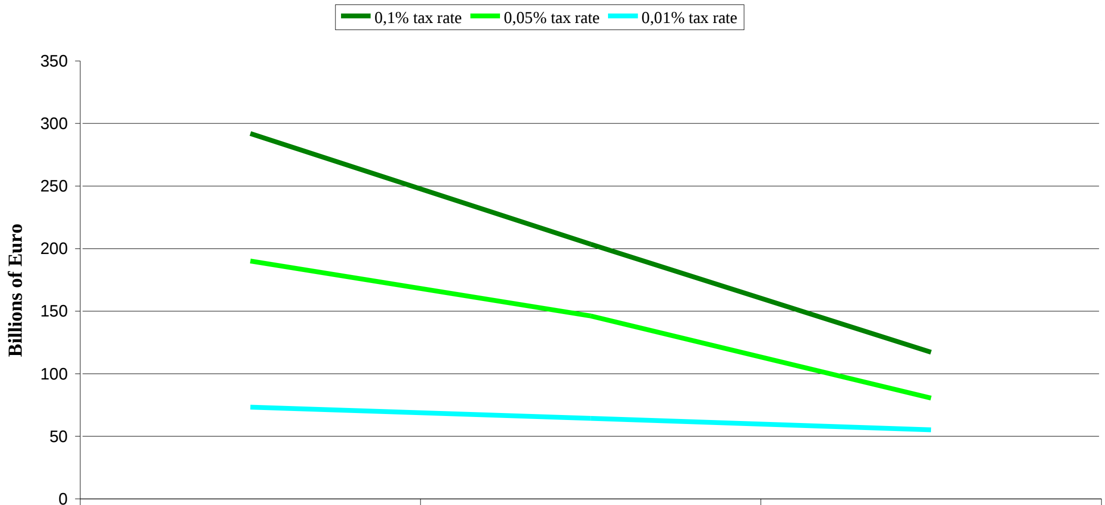
The General Agreement on Trade in Services (GATS) allows measures "for prudential reasons, including for ensuring the stability and integrity of the financial system". Therefore a similar justification can be applied as above for the *free movement of capital* in the EU i.e. on grounds of public interest.

---

argued that "complete freedom of movement of capital may undermine the economic policy of one of the member states or create an imbalance in its balance of payments". In Case C–101/05, *Skatteverket v. A* [2007] ECR I–11531, the court rules that „tax regimes are explicitly considered able to limit capital flows".

# Annex:

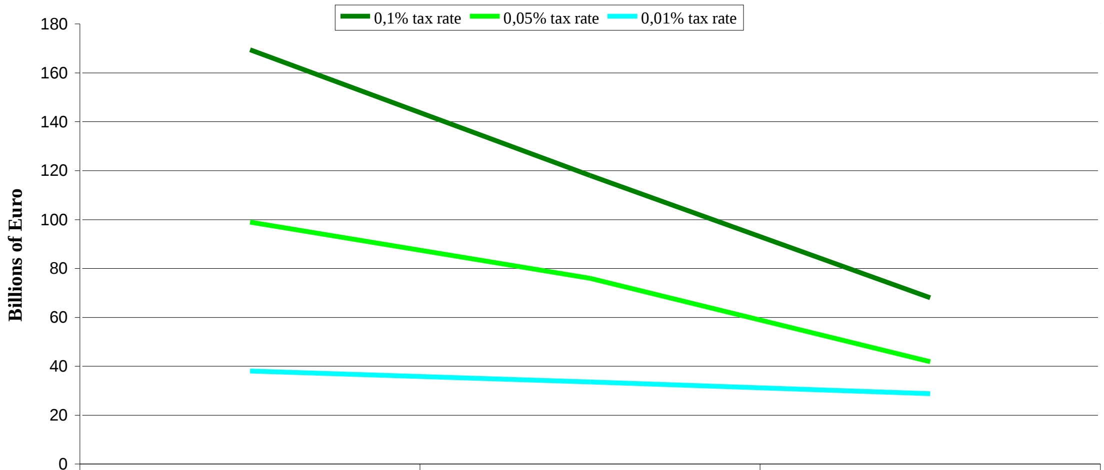
## Revenue of a EU 27 FTT (+ Norway, Switzerland)




| | Low reduction in transaction volume | Medium reduction in transaction volume | High reduction in transaction volume |
|---|---|---|---|
| 0,1% tax rate | 292,13 | 203,43 | 117,22 |
| 0,05% tax rate | 190,22 | 146,12 | 80,6 |
| 0,01% tax rate | 73,18 | 64,4 | 55,31 |

**Source: Greens calculation based on Schulmeister 2007 study for a FTT covering all transactions of shares and obligations plus 75% of the derivatives market transactions.**

## Revenue of a Eurozone FTT ( + non-eurozone EU MS collecting tax on the transactions of Eurozone financial assets)




| | Low reduction in transaction volume | Medium reduction in transaction volume | High reduction in transaction volume |
|---|---|---|---|
| 0,1% tax rate | 169,43 | 117,98 | 67,98 |
| 0,05% tax rate | 98,91 | 75,98 | 41,91 |
| 0,01% tax rate | 38,05 | 33,49 | 28,76 |

**Source: Greens calculation based on Schulmeister 2007 study for a EU27 FTT. Covers all transactions of shares and obligations plus 75% of the derivatives market transactions. The market share in transaction volume in the equity, obligations and derivatives market of non-Euro zone members is subtracted.**