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FINANCIAL TRANSACTION TAX

Abstract

This paper deals with the financial transaction tax in the European Union. While it is currently a matter of enhanced cooperation between several Member States regulated only at the national level, it is considered to be a potentially good source of the EU's own resources. The negotiations about its implementation on the EU recently begun again as there is need to search for funds for the economic recovery after the coronavirus pandemic.

The author works with the hypothesis that if the taxation of financial transactions and the financial sector as such is beneficial, harmonization within the free market of the European Union is necessary. From scientific methods, it will mainly use the analysis of proposals for a new system of taxation of financial transactions to confirm or refute it. In order to be able to put the issue into a suitable context, the method of interpretation will also be used, especially in the first chapter dealing with the issue of sectoral taxation. With regard to the problematic nature of the examined type of tax, a comparison will be made in several parts - while examining the current state and possible developments in the future. The professional literature does not yet deal with this topic, so it will be used rather in support of other sources, such as legislative documents of national and community institutions, and press releases.

In addition to processing the above hypothesis by the proposed methods, the aim of this work is also to provide an overview of the current state of affairs both at the level of the European Union

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and within the Czech Republic. Sectoral taxation is by its nature a political issue, so there is room for controversy about its suitability, effectiveness, and impact on society.

Key words: financial transaction tax, sectoral taxation, EU own resources

JEL Classification: K34, K2

1. Introduction

In 2011, the European Commission introduced a proposal to implement a financial transaction tax (hereinafter "FTT") in all (at that time) 27 Member States. The tax was supposed to be based on the use of financial instruments in transactions between financial institutions if at least one of the parties to the transaction is established in the European Union. The expected increase to the EU budget was approximately EUR 57 billion and was to be implemented from January 2014 [European Commission 2011].

Although economically strong countries (even a few smaller ones, such as Slovakia or Greece and Portugal) would welcome the introduction and harmonization of such a tax at the Community level, the proposal met insufficient support from the other Member States. At the 2012 ECOFIN meeting, national Ministries of Finance agreed that they could not reach a unanimous agreement on an EU-wide financial transaction tax proposal for the foreseeable future. However, there was room left for enhanced cooperation in this area for a subset of Member States[Council of the European Union, 2012].

Discussions on harmonizing financial sector taxation at EU level are now surfacing. The agreement on enhanced cooperation between the above-mentioned countries is currently being revised, however, some (for the time being) out-standing countries are also gradually introducing a variant of the bank taxation. This article aims to explain the reasons and possible benefits of this type of tax, and to examine the consequences of differences in national systems.

Author of this paper works with the hypothesis that if the taxation of financial transactions and the financial sector as such is indeed beneficial, harmonization within the free market of the European Union is necessary. To confirm or refute it, used scientific methods will consist mainly of analysis of proposals for a new system of taxation of financial transactions. To be able to put the issue into a suitable context, the method of interpretation will also be used, especially in the first chapter describing the issue of sectoral taxation. Regarding the problematic nature of the examined type of tax, a comparison will be made in several parts - when examining the current state and possible developments of things in the future. There is a lack of professional literature on the topic,

so it will be used rather in support of other sources, such as legislative documents of national and community institutions, and press releases.

Next to the processing the above hypothesis by the proposed methods, the aim of this work is also to provide an overview of the current situation both at the level of the European Union and in the Czech Republic. Sectoral taxation is by its nature a political issue, so there is room for controversy about its appropriateness, effectiveness, and impact in society.

2. Sectoral taxation

Sectoral taxation is always a politically sensitive topic and it has not yet been properly covered in the literature. It means taxation of a specifically defined area of business, where for other types of corporations such taxation either does not exist or is set to a much lower extent. Its application is possible only in the conditions of the so-called imperfect market [Holman 2007; 357-358], respectively its essence lies in assigning an economic disadvantage to a specifically defined section of the market. Although it could be viewed as a tool of prevention of monopolies in sectors where market entry costs are high, it can have discriminatory effect and cause distortion of competition. According to the interpretation of the Treaty on the Functioning of the EU by the European Court of Justice [Mason 2012], the anti-discrimination measures of companies owned by foreign entities may be violated by such an intervention. Among other things, there is also a risk of an outflow of foreign investors, from whose point of view the taxation represents an unfavourable increase in costs.

In addition to protecting a fair competitive environment, such a tax is often a means of increasing funds in response to the economic crisis. This is illustrated by the introduction of a a bank tax between 2009-2011, when Sweden, Finland, Denmark, Austria, Germany, as well as some of the other Member States, created reserves, which can only be used in the manner specified in the relevant legislation, in this way [Krček, Smetanková 2019].

Characterizing the bank tax as a specific measure shall be avoided and we should perceive it more as a methodology for regulating the banking sector. Bank tax includes three specific types - Financial Activities Tax (FAT), Financial Transaction Tax (FTT) and Balance Sheet Tax [Rahm 2011]. The aim is to settle the collapsed economy and preventively create rescue funds - increase of revenue to the state budget and to strengthen GDP. As such a crisis will mainly affect small and medium-sized enterprises and the population with lower and average incomes, the bank tax is aimed primarily at private individuals with a

high income derived from the activities of financial institutions (such as shareholders), albeit indirectly. It affects the companies themselves rather partially.

The advantage of this is a relatively efficient collection of funds in the state treasury without a significant direct negative impact on finances in the hands of citizens. It follows that the proposal for such a measure will not be too difficult to enforce, as it is possible to assume the popularity among the voters (but we must not forget that it is in the banking and investment sector that we find the strongest lobby). On the other hand, there is a risk that too high a bank tax rate may cause large institutions to outflow into other regions where doing business is more financially advantageous to them. When a tax liability is imposed, the bank's funds, which could be otherwise allocated to consumers, will inevitably decrease, which will negatively affect its business activities. At the same time, an increase in the price of ordinary services can be presumed.

A well-known example is the bank tax introduced in Hungary in response to the financial crisis of 2008, when the country faced approaching bankruptcy. The measure introduced both a tax on progressive assets of up to 0.53% and a tax on financial transactions (excluding cash). This led to a significantly reduced profit of financial institutions and thus to the closure of many branches, and the departure of several entities from the Hungarian market. According to the Confederation of Industry and Transport of the Czech Republic, banks did not move to countries with lower overall taxation. This shows that the problem is not the amount of income tax, but it is the additional taxation of a particular sector with regard to the overall economic and regulatory conditions [Confederation of Industry of the Czech Republic 2017]. As a response, bank tax rates began to fall, however, new sectoral taxes were introduced - in the water and gas industries, in advertising and in telecommunications. Because these are basic services necessary for citizens, it is them who ultimately bear the tax burden.

However, a bank tax is not unusual in highly developed economies. For example, Sweden or the Netherlands raise funds for a fund designated to rescue banks through taxation of their income with a low rate. Belgium has been operating with the financial transaction tax since 1993, the volume of taxation is derived from the type and value of banks' liabilities. A similar approach is applied in Germany. It is worth mentioning the situation of the Austrian Volksbank and Hypo Alpe Adria Bank, which were so-called too big to fail [Cyrrus 2014]. This refers to banks that have reached such a size and influence on the local market that their failure would have a significant negative impact on the whole country. In 2008, their assets fell so sharply that they had to be supported by a rescue fund created from bank tax revenues.

2.1. Czech environment

Germany and Austria are neighbouring countries of the Czech Republic and in a way also share economic patterns. It is therefore not surprising that the introduction of a bank tax is being discussed in our country as well. However, is the Czech environment well prepared for such a tax? What impact would a possible harmonization at European Union level have?

A special National Development Fund is an instrument that is to be created on the basis of income from the bank tax in the Czech Republic. Its aim is to support the implementation of the National Investment Plan and the government's legitimate efforts to increase the volume of investments in the Czech Republic. However, unlike the funds thus created abroad, this would serve more as a tool to increase the attractiveness of the Czech market for foreign investment than a potential source of crisis rehabilitation of banks. Currently, the Czech Parliament is discussing four forms of tax - taxation of bank assets, their profits, dividends, and reinvestment of part of the profit, which is not a tax in its true sense, because although the condition of involuntariness is met, certain return on investment can be expected (while creation of a rescue fund not). This taxation could bring 11-14 billion crowns to the state coffers [Bureš 2019].

As can be seen from this summary, sectoral taxation of the financial market is very diverse. Given the fact that the largest banks usually operate in at least a few countries of the European Union, where their services are commonly used by consumers established abroad, the effort to harmonize it up to at least to some level is directly offered. The bank tax is rather direct in its nature, which makes it belong in a group of taxes whose harmonization within the Union is still quite problematic.

3. Financial Transaction Tax

In the original proposal to introduce a common system of bank taxation based on the taxation of financial transactions (FTT) of 2011, the Commission gives two main reasons:

- The primary objective was to ensure that the financial sector makes a fair contribution during the period of recovery of Member States from the fiscal crisis, which severely affected both government budgets and those of citizens. Compared to other areas of business, the financial sector seems to have very little tax regulation, with financial services being exempt from VAT in most cases because

the tax base is very difficult to determine [European Commission 2011], and this new tax is intended to bring significant benefits to public budgets.

- The second reason is the expected elimination of fragmentation, an increase in quality and the stabilization of the single market. The minimum tax rates would be unified, thus compensating for some differences between Member States, which would help to anticipate and prevent the financial crisis in the future [European Commission 2011].
- In addition, the Commission's original proposal of September 2011 lists among the reasons for introducing a common financial transaction tax an effort to limit the execution of financial transactions which do not in fact contribute to the efficiency of the overall economy.

The tax would affect 85% of financial transactions determined according to certain criteria, excluding consumers and businesses. While the tax base would be harmonized primarily, the lower limits of the tax rate would be determined secondarily. According to the Commission, common rules would support the efforts of the Community economy to cope with strong economies (the Commission has ambitions to promote a harmonized bank tax also within the G20) [European Commission 2011] at the global level. The profit would be used in part to finance the functioning of the European Union and the remaining part would be distributed among the Member States, which could also have the effect of reducing and gradually eliminating membership fees [Council of the European Union 2012].

However, the legitimacy of this reason for implementation of the FTT at European level is a question. The essence of this tax is to create reserve funds to support financial institutions affected by the economic crisis, which are usually private entities. Their existence and quality of operation is essential for the functioning of the economy in the state. The activities of these entities have an impact on both consumer finances and the overall state of a country's economy. Thus, if the taxation of a private entity were to gradually replace the membership fees provided by States from sources arising from the collection of other taxes (mainly), the FTT lacks a real need and, on the contrary, rather indicates an effort by States to transfer their obligations to the private sector.

It is possible that in such a case, a revision of the value added tax on financial services would be more effective so that it can be used effectively to create these funds.

The proposal was discussed in 2012 by Member States' representatives at the ECOFIN conference. While economically stronger countries, some of which already work with some

variant of the bank tax, were in its favour, other states, including the Czech Republic, were fundamentally opposed. They argued mainly for the above-mentioned reasons - insufficient preparedness of the national economy, of which financial institutions are an essential part. Taxing them in the current economic conditions of the country could lead to a reduction in capital and profitability, an increase in fees and thus a loss of customers, and a gradual decline in branches and the outflow of institutions from their territory. However, most of these arguments against are common consequences of any taxation resulting from its nature as a State interference in private property. In order to use them validly, it will be necessary to carry out an in-depth analysis of the economic situation in the country and thoroughly examine these potential impacts by experts.

As Article 329 (1) of the Treaty on the Functioning of the European Union requires the approval of a qualified majority for the adoption of legislation with such a significant impact, eleven Member States (Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia, and Slovakia – thus not only traditionally strong economies) have decided at least to conclude an enhanced cooperation agreement in the field of financial transaction taxation within the meaning of Article 20 of the Treaty on European Union and 326-334 of the Treaty on the Functioning of the European Union. Since then, discussions on a common system of taxation of financial transactions at Community level have receded into the background.

The common financial transaction tax was re-discussed at the ECOFIN conference in 2019, where the proposal was described as complicated. The countries participating in enhanced cooperation (without Estonia) have decided to deepen their activities in this area and the idea of a common system for the whole of the European Union has reappeared. The two main points of the debate included the exclusion of pension products and the method of calculating the financial transaction tax revenue, which would guarantee a minimum profit for each Member State participating in enhanced cooperation (so-called mutualization) [KPMG 2019]. According to the German proposal, a financial transaction tax should be levied on the acquisition of shares in EU-listed companies and a market capitalization of more than EUR 1 billion in the previous year, on a change in ownership of shares in selected institutions (French model), while initial public offerings, market making, and normal trading would be exempted from the obligation. The planned allocation of selected funds is also interesting as it includes both the budget of the European Union and the budgets of the countries that are not yet part of the euro area. Implementation expected in the following year (2021).

Let's look at the proposal in more detail - the primary goal is to strengthen the competitive environment and at the same time functionally harmonize the various markets, especially those located in countries that are about to adopt the euro as their currency in the foreseeable future [Euractiv 2018]. There is an idea behind this, that a harmonized bank tax will increase the volume of foreign investment in these countries, which will both help the national economy to meet the conditions for joining the euro area and strengthen the euro in the currency market. In the end, the possibility of using the tact of the funds obtained to compensate for a possible economic crisis was ruled out from the justification of the need (which was promoted mainly by France and the Commission). This is an interesting decision because, as mentioned above, funds made up of selected sector taxes are usually intended primarily as a policy in the event of a threat to the economy. According to the ministers of other states in the group of enhanced cooperation, the crises would be addressed as follows: countries with stable economies would be partially involved in financing investment projects in weak states with a significant decline in economic performance, whereas such a decline will only be defined on the basis of economic forecasts [Euractiv 2018]. This would create a new instrument, supposedly more effective and flexible on the basis of a shorter timeframe, during which stable states would provide resources to the weaker ones, differently from the traditional cohesion and structural funds.

More specifically, the proposal provides for the taxation of transactions of those institutions which exceed EUR 1 billion value in the market of one Member State. In total, a profit of 3.5 billion euros is expected for the 10 countries of the enhanced cooperation together. The planned revenue for each Member State participating in the mutualization mechanism is EUR 20 million. This can act as an incentive for the participation of economically weaker countries, which would otherwise be expected to have only a low revenue from the collection of this tax [KPMG 2019]. However, it should be borne in mind that this proposal still affects only less than half of the Member States and does not include countries whose economies have ambitions to develop in very interesting directions[1].

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[1] E.g. Estonia, which is home to the TransferWise application, which enables fast and cheap currency transfers, cross-border payments and borderless account management. These types of financial products are gaining in popularity and opening up space for potential regulation in the future.

3.1. Bank Tax

As mentioned in the previous section, bank tax has many variants within Europe and several variants of profit determination. There are also several different impacts on both the banks themselves and their customers - whether consumers or businesses. We have a sectoral and very specific tax here, which, moreover, is applied and harmonized only in part of the European Union. Most banks and financial institutions operating on the Czech market operate also internationally - not only in the European Union but have branches (or headquarters) outside it as well. If a very different tax liability is imposed on a branch of such an institution in each country, this leads to an increase in uncertainty on the part of the customer, but above all to an increased administrative burden and double taxation and is related to each other.

Proposal for a directive on enhanced cooperation in the area of financial transaction tax from 2013 came out at a time of very good situation for the profitability of financial institutions, made possible, among other things, by exemption from VAT, regulation of the financial sector, and security provided by governments. However, in individual countries there were special tax regimes for financial transactions, while in others there was a tendency to introduce new ways of taxing the financial sector [Rychtaříková 2015] which had significantly conflicting effects. This has, of course, led to even greater market fragmentation and distortions of competition in financial instruments. Such a tax policy could not have the desired effect of discouraging transactions that draw funds from other economic sectors, while not contributing to greater efficiency in the functioning of markets.

The inefficient allocation is due to the loss of the bank's funds, which would otherwise be intended for the provision of credit, which is one of the main activities of banks in addition to the implementation of payments between customers and the acceptance of deposits. If the bank's ability to provide loans is limited, the business quality of the institution also decreases. At the same time, a lower volume of funds also leads to lower profitability, which will be reflected in higher fees and reduced interest rates. If the conditions are not taxed very well, fair competition is distorted.

Double taxation can then occur mainly in the relationship between parent companies and subsidiaries. There are several branches and related banks in the Czech Republic, whose mother is established in one of the countries where the bank tax is introduced in one of its variants (Germany, Belgium, Austria). While the direct impact of taxation of the mother on the daughter is not yet clear, the moment the tax is levied on both units, the following

situation arises: the subsidiary pays part of its profits to the mother. This profit is (say in the Czech Republic) reduced by both corporate income tax and bank tax. The mother (for example in Germany) who receives this amount recognizes it as her profit. This means that the amount will again be taxed on both corporate income tax and bank tax. However, this is only a hypothetical situation that has not yet been empirically verified.

where all the negative effects described may result in an imbalance in the benefits of the product (considering input and output values such as invested labour and capital and income), where a certain level of taxation in conjunction with the effort required to meet the tax liability causes loss of motivation of the taxpayer not only to pay taxes, but ultimately to maintain continuation of business in the taxable sector. To illustrate such a situation, the Laffer curve is used, which works with the dependence of the volume of funds collected through a specific type of taxation on the tax rate. Thus, the tax can only grow to a certain point, where the selected funds will be maximized, and from this point it is no longer possible for them to grow due to various factors, because taxpayers will stop generating a taxable product due to the tax. According to Hájek, however, this point is difficult to determine precisely because of the high number of influencing factors [Hájek 2009; 16], which are variable and cannot be reliably predicted.

According to the author, when presenting any new taxes, it is necessary to keep in mind the rational behaviour of the tax subject, which includes a number of factors. While the economic limit of efforts to optimize the benefits of negotiations is usually obvious, the psychological limit of tax liability is often elusive. An inappropriately set scheme in society evokes anti-tax sentiment, which often leads to tax evasion [Tomášková 2014; 115].

4. Additional chapter on the COVID-19 pandemic impact

This short chapter is a response to the adoption of the EU's long-term budget for 2021-27, which includes the NextGenerationEU program aimed at supporting the recovery of economies affected by the coronavirus pandemic. Although this is not the subject of this article, I would like to mention the fact that the budget negotiations have emphasized the need for the EU to expand the range of own resources. Currently, these include customs duties, Member States' VAT-based contributions and GNI-based contributions. In addition, a new system of Member States' contributions related to the production of non-recyclable plastic waste is introduced from this January [European Commission 2018[2]]. From June,

[2] The plastic own resource(1) will be proportional to the quantity of non-recycled plastic packaging waste generated in each Member State with a correction mechanism to avoid excessively regressive

income based on the carbon border adjustment mechanism, digital tax and the EU Emissions Trading System is expected.

Interesting, however, is the plan for 2024, which, in addition to the Common Consolidated Corporate Tax Base, which has been under way for a long time, provides for unspecified financial contributions linked to the corporate sector, and in particular the financial transaction tax [European Commission 2020]. Introductory provisions of Council Decision 2020/2053, in its eighth paragraph, it states that the financial transaction tax may be included among own resources. However, there is still lack of information on what the financial transaction tax should look like in this context, whether it shall involve all Member States or only those already participating in the enhanced cooperation, and other requirements.

Experts believe that, compared to other sectors, the banking sector is minimally affected by the crisis, which contributes to the assumption that their taxation is fair. Furthermore, six of the Member States (Belgium, Finland, France, Ireland, Italy, and Poland) which already apply the financial transaction tax have been shown not to have shown any damage to the competitiveness of the taxable persons [Nuti 2020]. If the financial transaction tax plan were more ambitious, it would be a very effective, creative, and low-cost solution to financial imbalances. According to Richard Murphy[3] the financial transaction tax can be an effective tool for controlling employment demand and inflation, because in an environment of persistent government deficits, rapid fiscal interventions are necessary, which the current instruments are not able to reach [Murphy 2020].

5. Conclusion

The situations described above may arise as a result of sectoral taxation, harmonization of only some Member States seems to be only slightly more effective than none. The very high mobility of most of the transactions concerned easily leads to market distortions if the

impact on national contributions. This will provide an incentive for Member States to reduce the quantity of plastic packaging waste. Member States will design the most suitable measures to reduce the quantity of the non-recycled plastic packaging waste. They can achieve this objective through a pricing instrument (as a tax or charge) but also via regulation or promoting better recycling.
The proposal for an own resource based on non-recycled plastic packaging waste is not a tax, but a contribution by the Member States to the EU budget, which aims at implementing the objectives of the Plastic Strategy and supporting the EU recycling objectives. In full respect of subsidiarity, there is no obligation for Member States to seek a contribution on the non-recycled plastic packaging waste from actors at national level.

[3] Richard Murphy is a political economist, Professor of Practice in International Political Economy at City University, London and Director of Tax Research UK.

rules in each country are implemented independently of each other. Enhanced cooperation cannot be a sufficient measure to prevent these negative effects due to its geographical limited nature.

If more Member States introduced this tax without being included in the enhanced cooperation scheme at the same time, this could lead to even more complex market fragmentation. Although the new proposal brings a certain solution, which also thinks of those states that are not yet preparing for this step, it brings a certain inequality. Given that this is an area of direct taxation, which encroaches on the property rights of private entities and as described in the text, will affect consumers, negotiations will be challenging and the creation of an effectively functioning system at EU level cannot be expected in the coming years.

Given the need to build up a financial stockpile to cover the downturn in the event of another economic crisis, a financial transaction tax seems to be a high-quality and effective tool, so it can be assumed that states will gradually abandon the sceptical approach and start introducing it. To maintain the coherence of the internal market for financial services, harmonization will be most appropriate, both with regard to the prevention of tax evasion and double taxation, as well as the reduction of other risks of distortion of competition in the EU single market. There are basically the same goals in the directive and in the approaches of individual governments, which they want to achieve through this type of taxation, but this is not possible if each state acts alone and in an uncoordinated manner with the others. The hypothesis set out in the introduction to the article on the need for harmonization at EU level, if the introduction of a financial transaction tax proves to be the right step, is necessary and should be pursued at global level as well.

This is a relatively politically sensitive topic, where the public debate shows a lack of transparency and its complexity contributes to the difficulty of understanding it by citizens. The author believes that the application of sectoral taxation, especially the discussed taxation of financial transactions, which ultimately has an impact on consumers, should be introduced only if the political system in the countries where the political scheme works reliably, and voters have confidence in their representatives that the tax will be effective and designed to minimize potential negative consequences and significantly outweigh future benefits. However, in view of the financial crisis caused by the coronavirus pandemic, the financial transaction tax is a very welcome tool by experts. All that leads the author to conclude that, although not perfect, the financial transaction tax is currently the best available economic recovery tool in the European Union.

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