VII. Securities Transaction Taxes: Should the Legislature Act as Robin Hood?

A. Introduction

Securities transaction taxes ("STT") have been an area of debate for over a century. During the Great Depression, economist John Maynard Keynes suggested that the United States use an STT to limit speculation in financial markets by increasing transaction costs on short-term trading.[1] Nobel laureate James Tobin advocated a similar idea in 1972, encouraging a worldwide tax on foreign transactions for the purpose of reducing disruptions in foreign exchange markets.[2] Since the financial crisis of 2008, there has been a resurgence of interest in the topic with supporters proposing legislation meant to establish taxes on securities transactions. Currently, the United States has limited securities taxes, but as our economy is perpetually in flux, so is its regulation. Today, amidst the public's fear of "going over the fiscal cliff," and Main Street's lingering anger with Wall Street, many are encouraging the legislature to once again rethink the viability of securities transaction taxes.[3] Whether or not this "Robin Hood" type tax will help or hurt the economy, however, is presently unknown.[4] This article explores recent domestic and international legislative proposals as well as the

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[1] MARK P. KEIGHTLEY, CONG. RESEARCH SERV., R41192, A SECURITIES TRANSACTIONS TAX: FINANCIAL MARKETS AND REVENUE EFFECTS 1 (2012) [hereinafter CRS REPORT R41192]. Keynes believed an STT would have to balance "the desire to curb speculative bubbles vs. the desire not to impair the financing of real enterprise," a key component of the debate to this day. Thornton Matheson, *Taxing Financial Transactions: Issues and Evidence* 12 (Int'l Monetary Fund, Working Paper 11/54, 2011).

[2] CRS REPORT R41192, *supra* note 1, at 1 ("[T]he 'Tobin Tax', is technically different from an STT because it only applies to foreign currency transactions, but is substantively similar to an STT.").

[3] *See, e.g.*, Alain Sherter, *Securities Trading Tax Could Raise Big Bucks*, CBS MONEY WATCH (Dec. 21, 2009, 1:40 PM), http://www. cbsnews. com/8301-505123_162-43542842/securities-trading-tax-could-raise-big-bucks/.

[4] Frank Holmes, *Risk Of Going Hungary With A Financial Transaction Tax*, FORBES (Sept. 27, 2012, 12:19 PM), http://www.forbes.com/ sites/greatspeculations/2012/09/27/risk-of-going-hungary-with-a-financial-transaction-tax/ (describing securities transaction taxes as "the Robin Hood deed of 'stealing from the rich to help the poor'").

arguments for and against these kinds of taxes. Accordingly, Part B outlines what securities transaction taxes are; Part C discusses the history of these taxes in the United States; Part D looks at recent domestic and international legislative proposals; and Parts E and F discuss arguments in favor of and against securities transaction taxes.

B. What Is a Securities Transaction Tax?

A securities transaction tax is a tax on the trade of financial instruments. An STT may be imposed on all or just certain types of securities (e.g., stocks, bonds, mutual funds, exchange-traded funds, futures, options), and can include initial offerings of securities or only secondary market trades.[5] Additionally, the tax may be imposed as a flat-fee per trade or based on a security's market value.[6] Further, an STT may apply to all securities traders, or to only certain types, such as institutional traders.[7] Though zealous opponents and proponents of an STT exist in the United States, the complete fiscal consequences of such a tax remain unknown.[8] It is perhaps this uncertainty that has driven the fluctuations in STT legislation in the United States throughout the past century.

C. History of the STT in the United States

The United States enacted an STT in 1914 in response to the effects of World War I that lowered customs revenue and cost the country billions of dollars each year.[9] The House Report discussing the proposed tax concluded that this deficit had to be made up by taxes from other sources.[10] Exploring this solution, the Committee on Ways and Means picked areas it determined would be the easiest to

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[5] Matheson, *supra* note 1, at 5; *ICI Resources on Securities Transaction Tax*, INVESTMENT CO. INST., http://www.ici.org/stt (last visited Mar. 10, 2013).

[6] Matheson, *supra* note 1, at 5.

[7] MARK P. KEIGHTLEY, CONG. RESEARCH SERV., R42078, A SECURITIES TRANSACTIONS TAX: BRIEF ANALYTIC OVERVIEW WITH REVENUE ESTIMATES 1 (2012) [hereinafter CRS REPORT R42078].

[8] Matheson, *supra* note 1, at 5.

[9] H.R. REP. NO. 63-1163, at 1–2 (1914).

[10] *See id.* at 5.

tax, which included alcohol, oil, and tobacco,[11] as well as a provision for a stamp tax (in effect an STT).[12]

The 1914, STT imposed a tax of .02% on the par value of a stock.[13] Between 1932 and 1958, the tax rate on a stock's par value varied between .04% and .06%.[14] In 1959, the tax rate returned to .04%, though the tax now applied to the market value of a stock.[15] In 1965, however, Congress repealed the tax as part of the Excise Tax Reduction Act of 1965, a legislative attempt to "remove unnecessary impediments to economic growth" while the country's fiscal future was bright.[16] Congress considered STTs once again in the 1980s and 1990s, during both the Bush and Clinton administrations, though none of the proposals were enacted into law.[17]

Currently, the SEC charges a transaction fee on securities.[18] Under section 31 of the Securities and Exchange Act of 1934, self-regulatory organizations, such as the Financial Industry Regulatory Authority ("FINRA") and the national securities exchanges, "must pay transaction fees to the SEC based on the volume of securities that are sold on their markets."[19] These fees help fund the SEC's

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[11] *See id*. at 5–7. ("The question, then, arises as to what source we shall turn to secure the additional revenue; what taxes can be levied that will respond to the Government's needs immediately and be of the least burden to the people who are compelled to pay them?").
[12] The stamp tax provision basically reenacted the stamp-tax sections of the war-revenue act of 1898. *Id.* at 7.
[13] *Fact Sheet: Transaction Tax History*, INVESTMENT CO. INST., http://www.ici.org/stt/ici_resources/10_stt_history (last visited Mar. 29, 2013) ("Par value is a legal concept that bears no relation to market value. Typically, a stock's par value is significantly lower than its market value; this has been the case since at least the mid-1950s".).
[14] *Id.*
[15] *Id.*
[16] *Id.* (claiming "the tax was viewed by Congress as complicating securities transactions."); CRS REPORT R41192, *supra* note 1, at 20 ("[T]he Excise Tax Reduction Act of 1965 . . . also repealed a number of other excise taxes, many of which were imposed to deal with the emergencies during the Great Depression or wartime.").
[17] CRS REPORT R41192, *supra* note 1, at 20 ("Some of these proposals were targeted to narrow segments of financial markets, such as trades in derivatives, while others were broader and covered most financial transactions.").
[18] *See "SEC Fee"—Section 31 Transaction Fees*, SEC (Aug. 15, 2007), http://www.sec.gov/answers/sec31.htm.
[19] *Id.*

visitorial activities.[20] Therefore, Section 31 is not *technically* a tax imposed on individual investors.[21] However, the self-regulatory organizations charge their members fees, which in turn cause member broker-dealers to charge their customers fees and ultimately pass the financial burden down to the individual investor.[22] The SEC adjusts the fee rate annually or semi-annually, to make the collection of fees in a given year as close as possible to the amount stipulated for that year by section 31.[23]

D. Recent Domestic and International Proposals

1. Domestic Proposals

Since 2008, Congress has frequently proposed new attempts at STT legislation. The 111th Congress proposed several STT bills.[24] For instance, Representative Peter DeFazio (D-OR) proposed H.R. 4191, known as the "Let Wall Street Pay for the Restoration of Main Street Act of 2009," for the purpose of "impos[ing] a tax on certain securities transactions to fund job creation and deficit reduction."[25] The proposal was met with opposition from other members in Congress, with thirty-six House Members sending letters expressing their discontent to the Ways and Means Chairman.[26] Even some Democrats criticized the proposal, especially the efficacy of implementing an STT.[27] Despite this bipartisan opposition, the 112th Congress continued along the same line, introducing six bills on the

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[20] *Id.*
[21] *Id.* ("Although some broker-dealers have described this charge as an 'SEC fee,' the SEC does not actually impose this fee on individual investors.").
[22] *Id.*
[23] *Id.* For current Section 31 fees, *see Frequently Requested Documents*, U.S. SEC. & EXCH. COMM'N (Nov. 19, 2012), http://www.sec.gov/divisions/marketreg/mrfreqreq.shtml#feerate.
[24] CRS REPORT R41192, *supra* note 1, at 1 (listing proposed bills, including H.R. 676, H.R. 1068, H.R. 3151, H.R. 3379, H.R. 4191, H.R. 4646, and S.2927).
[25] *Id.*; H.R. 4191, 111th Cong. § 2(7) (2009).
[26] CRS REPORT R41192, *supra* note 1, at 1.
[27] At time, U.S. Treasury Secretary Timothy Geithner stated that "firms are 'going to move in a heartbeat to get around any tax like that'" and Speaker of the House Nancy Pelosi conditioned her interest on whether the tax would be pursued in coordination with other countries. *Id.* at 2.

matter.[28] These bills focused more on supporting the middle class than on penalizing Wall Street (as can be evidence in their titles)[29], though the goals remained the same as those from the 111th Congress.[30] Most recently, Rep. DeFazio reintroduced a STT bill in the 113th Congress, and the House Committee on Ways and Means will consider the bill.[31]

2. International Proposals

Many international governments have imposed, or are considering imposing, some kind of STT.[32] For example, France enacted a tax on financial transactions in August 2012,[33] levying a 0.2% tax on purchasing transactions of equities of large French

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[28] The 112th Congress proposed H.R. 1125 which would have imposed "a 1.00% transaction 'fee' [on] all transactions in the economy, not only securities transactions." CRS REPORT R41192, *supra* note 1, at 1. The 112th Congress also proposed H.R. 3313, H.R. 3638, H.R.5727, S. 1787, and S. 2252 which would have "impos[ed] a three-basis-point tax (0.03%) on non-consumer transactions involving stocks, bonds, futures, options swaps, and credit default swaps." *Id.*

[29] *See e.g.,* Rebuild America Act, H.R. 5727, 112th Cong. (2012); Act for the 99%, H.R. 3638, 112th Cong. (2011); Wall Street Trading and Speculators Tax Act, H.R. 3313, 112th Cong. (2011).

[30] *See e.g.*, H.R. 5727 at 1 ("To rebuild the American middle class by creating jobs, investing in our future, building opportunity for working families, and restoring balance to the tax code."); H.R. 3638 at 1 ("To create American jobs and reduce the deficit . . .."); H.R. 3313 at 1 (aiming "to amend the Internal Revenue Code of 1986 to impose a tax on certain trading transactions").

[31] H.R. 880, 113th Cong. (2013) (introduced and referred to House committee on February 28, 2013). GovTrack.us is not optimistic about the bill's passage, however, estimating H.R. 880's prognosis at a 0% chance of passing through the committee. *H.R. 880: Wall Street Trading and Speculators Tax Act*, GOVTRACK.US, http://www.govtrack.us/congress/bills/113/hr880 (last visited Mar. 29, 2013).

[32] CRS REPORT R41192, *supra* note 1, at App. B (displaying a chart of specific regulations by country).

[33] *FAQs: French Financial Transaction Tax*, EUREX CLEARING, http://www.eurexclearing.com/clearing-en/resources/faqs/?frag=187982 (last visited Mar. 10, 2013) ("All transactions settled and traded on or after the effective date of the law (1 August 2012) are subject to tax.").

firms.[34] Other transactions subject to the tax include high frequency trading and trades in sovereign credit default swaps.[35] An additional provision, held off until early 2013, is meant to include American depository receipts (ADRs) that are based on French equities.[36] The Act includes various exemptions, including a market maker exemption,[37] a convertible bonds exemption,[38] a securities financing exemption,[39], and a primary market exemption,[40] as well as exemptions for transactions performed by a clearinghouse or securities depository,[41] and intra-group, restructuring, and employee saving schemes.[42] These exemptions allow the necessary flexibility to satisfy client needs while maintaining the strict regulation of speculative trading.[43]

In May 2012, the European Union proposed their own STT, calling for a .1% tax on stocks and bonds, and a .01% tax on

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[34] John D. McKinnon, *French Stock-Trading to Hit American Investors*, WALL ST. J. BLOG: WASHINGTON WIRE (Nov. 30, 2012, 5:58 PM), http://blogs.wsj.com/washwire/2012/11/30/french-stock-trading-tax-to-hit-american-investors/.

[35] *FAQs: French Financial Transaction Tax*, *supra* note 33 (clarifying that these types of transactions will have a tax rate of .1% of the transaction amount, unlike the .2% rate on equities purchases).

[36] McKinnon, *supra* note 34 ("ADRs are certificates representing foreign shares that are traded on U.S. exchanges . . . . [T]he tax will apply even though the affected ADR trades occur in the U.S. between American buyers and sellers.").

[37] LANDWELL & ASSOCIÉS, FRENCH FINANCIAL TRANSACTION TAX ON EQUITY SECURITIES: LATEST DEVELOPMENTS AND PRACTICAL IMPLICATIONS FOR THE MARKET 6 (2012), *available at* http://www.pwc.be/en/financial-services-newsalert/2012/landwell-fftt-pdf-aug-2012.pdf ("The objective . . . is two-fold: avoiding (*i*) a cascading effect and (*ii*) any impact on the market liquidity.").

[38] *Id.* at 8.

[39] *Id.* at 8–9.

[40] *Id.* at 9 ("Acquisition and subscription transactions performed as part of the issuance of equity or assimilated securities are exempt").

[41] *Id.* ("Transactions performed by a clearinghouse or securities depository as part of their respective regulated operations are exempted").

[42] *Id.* at 9–10 ("Some intra-group and restructuring transactions are exempted . . . [and u]nder certain conditions, the acquisition of equity securities in the context of employee savings regimes may also be exempted.").

[43] *Id.* at 6.

derivatives.[44] International history and rationale for adopting STTs mirror those in the United States. Thus, STTs have been reduced or eliminated during the last few decades, "largely to reduce transaction costs in line with a global trend."[45] However, in the years since the financial crisis, countries have been reinstating or increasing STTs as they attempt to weather their own economic difficulties.[46] Like in the United States, the STT proposal has been opposed by some EU member states including most notably the United Kingdom.[47]

E. Proponents of a Securities Transaction Tax[48]

The main arguments in support of an STT are that (a) the tax would raise federal revenue for various purposes and reduce the budget deficit and (b) the tax would curb speculative financial market excesses.[49] There is no doubt that imposing an STT could generate a significant amount of federal revenue.[50] Supporters contend that the government could use this extra money to enhance jobs programs or contribute to reducing the country's debt, and the tax would decrease dependence on financial trading in the American economy.[51]Moreover, many analysts feel that "an excessive share of the economy's resources is being consumed by the financial sector,"[52] and that such a tax "may be an effective way of raising money from an industry that has plenty to spare."[53] According to an analysis done by economists at the Center for Economic Policy Research and the University of Massachusetts-Amherst, an STT of

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[44] CRS REPORT R41192, *supra* note 1, at 2.
[45] *Id.* at 20.
[46] *Id.* at 20.
[47] *Id.*
[48] For the opinions on STTs from prominent religious, political, and economic leaders, see CTR. FOR ECON. & POLICY RESEARCH, STATEMENTS OF SUPPORT FOR A FINANCIAL TRANSACTION TAX (FTT) 1–6 (2012), *available at* http://www.cepr.net/documents/ftt-support.pdf.
[49] Matheson, *supra* note 1, at 4.
[50] CRS REPORT R41192, *supra* note 1, at 1.
[51] Sherter, *supra* note 3.
[52] DEAN BAKER, ROBERT POLLIN, TRAVIS MCARTHUS & MATT SHERMAN, CTR. FOR ECON. & POLICY RESEARCH & POLITICAL ECON. RESEARCH INST., THE POTENTIAL REVENUE FROM FINANCIAL TRANSACTIONS TAXES 1 (2009).
[53] Sherter, *supra* note 3.

.05% in the United States[54] could raise an estimated $353 billion per year.[55] Even if, as the authors of the analysis acknowledge, an STT results in a decrease of trading volumes, the tax would still bring in significant revenue.[56]

The authors of the H.R. 4191 legislation believe that imposing an STT as a way to generate federal revenue is logical and appropriate.[57] They contend that "the American taxpayers bailed out Wall Street during a crisis brought on by reckless speculation in the financial markets," and "there is no question that Wall Street can easily bear this tax."[58]

Additionally, proponents argue that an STT would curb speculative behavior in the financial markets by cutting down on the kinds of short-term trades that destabilize the markets.[59] The tax would cut down on these short-term, high frequency trading activities by rendering some of the oft-used trading strategies worthless.[60] In general, tax policymakers analyze how proposed taxes might affect constituents based on their "institutional form (corporations versus individuals), trading pattern (short-term traders versus long-term traders), and income level (higher-income taxpayers versus lower-income taxpayers)."[61] Recent STT drafters have focused on trading patterns in particular, as part of their attempt to draft a bill that will quell destructive speculation and avoid systemic risk.[62] The burden of an STT on taxpayers is contingent on the frequency of their trades, making the once lucrative short-term trades now cost more than they arere worth. As a result, "a low rate STT might impose a negligible burden on investors holding assets

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54 BAKER ET AL., *supra* note 52, at 2 (taxing stocks and equities, bonds, options premiums, foreign exchange spot transactions, futures, and swaps, and assuming a 0% reduction in trading volume).
55 *Id.* (using calculations based on 2008 trading volumes).
56 *Id.* at 2–3. (exploring various scenarios, the authors conclude if market activity decreased 25 percent, potential annual revenue from the tax would fall to $265 billion; with a 50% decrease, revenue comes in at $177 billion).
57 *See Democrats Propose Securities Transaction Tax*, ACCOUNTING TODAY (Dec. 3, 2009), http://www.accountingtoday.com/news/Democrats-Propose-Securities-Transaction-Tax-52610-1.html (quoting Sen. Tom Harkin, and Rep. Peter DeFazio).
58 *Id.* (quoting Sen. Tom Harkin, and Rep. Peter DeFazio).
59 CRS REPORT R42078, *supra* note 7, at 3.
60 *Id.*
61 CRS REPORT R41192, *supra* note 1, at 14.
62 *Id.* at 16.

for a long period of time, but it might represent a significant burden for frequent traders."[63]

F. Opponents of a Securities Transaction Tax

The main arguments against an STT are that it will lead to market distortion and result in unintended harm to individual investors and the middle class.[64] Opponents insist that a STT will likely have negative effects on investors and in turn the economy as a whole.[65] These effects would include impaired liquidity and price discovery, which hamper market efficiency and encourage trading in outside markets.[66] Additionally, research studies on the effects of an STT are not conclusive. Some studies show that STTs will have a "predictable effect . . . on asset valuation and trading volume, with implications for liquidity and price discovery."[67] Other economists

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[63] *Id.* at 15–16 (showing that at a certain level of "trading frequency, the burden of an STT liability would likely eliminate the possibility of profit on those transactions").

[64] Dale Brown, *A Securities Transaction Tax Will Hurt Advisors and Clients*, ADVISORONE (Oct. 4, 2012), http://www.advisorone.com/2012/10/04/a-securities-transaction-tax-will-hurt-advisors-an ("Rather than cutting into earnings, the tax would be passed on to the investors who can least afford an additional squeeze on their finances, especially when it comes to their already fragile ability to save.").

[65] *See generally ICI Research and Background on Transaction Tax*, INVESTMENT CO. INST., http://www.ici.org/policy/tax/leg/09_chamb_tax_bkgd1 (last visited Mar. 29, 2013).

[66] *Id.* An example of such situation can be found after Sweden's increase of their FTT in 1986: "[H]alf of all trading in Swedish equities migrated outside the country. Meanwhile, stock price volatility on Swedish markets showed no change after the tax was imposed." Paul Schott Stevens, *Don't enact financial transaction taxes*, CONGRESS BLOG (Dec. 20, 2012, 4:00 PM), http://thehill.com/blogs/congress-blog/economy-a-budget/274007-dont-enact-financial-transaction-taxes. For another example of a country cited for it's failed implementation of an STT, see ERIC M. SCHMITTERER, GEORGE W. BUSH INSTITUTE, EVIDENCE IN OPPOSITION TO SECURITIES TRANSACTION TAXES: THE CASE OF JAPAN 5 (2011), *available at* http://www.bushcenter.org/sites/default/files/Evidence%20in%20Opposition%20to%20Securities%20Transaction%20Taxes%20The%20Case%20of%20Japan.pdf ("Japan's transactions tax was shifting trading outside of Japan, decreasing asset prices, creating greater autocorrelation, and was showing little if any evidence of reducing market volatility").

[67] Matheson, *supra* note 1, at 5.

believe the imposition of an STT could have unknown effects on trading volumes.[68] The effects of an STT on "market dynamics, including short- and long-term price volatility" also remain unconfirmed.[69]

Allen Atkins and Edward Dyl, economic researchers at the University of Arizona, oppose an STT[70] because they believe an STT will not reduce the volatility of stock prices, and may actually increase it.[71] Furthermore, the researchers could not confidently interpret their data. While they found a positive relationship between volatility and changes in trading activity, they could not determine whether the effects were due to short-term speculation or the noise of new information.[72] Similarly, though an STT could reasonably be expected to yield significant revenue, "the unavailability of data on certain financial transactions that could be subject to an STT and the breadth of securities that may be included . . . complicate any revenue estimation."[73]

In conjunction with its goal of making Wall Street pay for the harm it has caused to the economy, the authors of proposed STT legislation intend for the taxes to primarily affect large financial institutions.[74] The Financial Services Institute ("FSI") and the Investment Company Institute ("ICI") argue, however, that the costs of an STT would ultimately be passed on to small investors, which will discourage investing and have the most negative effects on the savings of the middle class.[75] Additionally, if taxed by an STT, advisors and broker-dealers would most likely charge more for their

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[68] CRS REPORT R41192, *supra* note 1, at 11.
[69] Matheson, *supra* note 1, at 5.
[70] Allen B. Atkins & Edward A. Dyl, *Stock Price Volatility, Transactions Costs and Securities Transactions Taxes*, 18 MANAGERIAL &. DECISION ECON. 709, 717 (1997).
[71] *Id.* at 710 (discussing the authors' study on "the empirical relationship between investors' holding periods and bid-ask spreads for common stocks" and other sources of support for the same conclusion).
[72] *Id.* at 717 ("It is [] unlikely that the stock price volatility we observe is due to short-term speculation, and more likely that it is due to the arrival of new information.").
[73] CRS REPORT R42078, *supra* note 7, at 3.
[74] Brown, *supra* note 64.
[75] *Id.; ICI Resources on Securities Transaction Tax, supra* note 5 ("ICI believes that any such tax could harm individual fund investors who are investing to meet retirement, education, and other financial goals.").

services.[76] The ICI looked at recent STT proposals meant to exempt middle-class investors from the tax, and concluded that the provisions will not "effectively shelter individual mutual fund investors from the tax."[77] Altogether, problems caused by an STT could drive investing offshore,[78] and, according to the FSI, "would discourage investing at a time when our nation can least afford it."[79]

In sum, between transaction costs, financial complexity, and the administrative burden, opponents conclude that any benefits of an STT "would be dwarfed by the harm it would inflict on America's savers."[80]

G. Conclusion

There are several options regarding STT legislation: Congress can keep the current SEC fee, enact new legislation that increases and expands STTs, or repeal securities taxes all together. Those in favor of an STT believe the tax will improve operations in the financial market and contribute much needed federal revenue.[81] Those opposed believe the tax will result in market distortion and unintended harm to the middle-class.[82] These conflicting opinions are complicated by the lack of data to predict potential outcomes.[83] However, both proponents and opponents agree that tighter financial regulations would solve some of the problems an STT would address. This common ground could form the basis for a legislative compromise that both controls reckless speculative trading, and also preserves the integrity of our financial markets.

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[76] Brown, *supra* note 64 ("Advisors and broker-dealers would most likely charge higher commissions and fees in response to a transaction tax.").
[77] *ICI Research and Background on Transaction Tax*, *supra* note 65.
[78] Matheson, *supra* note 1, at 12.
[79] Brown, *supra* note 64.
[80] Stevens, *supra* note 66.
[81] CRS REPORT R41192, *supra* note 1, at 16.
[82] *See generally* Brown, *supra* note 64.
[83] Atkins et al., *supra* note 70, at 717.
[84] Student, Boston University School of Law (J.D. 2014).