TAXATION OF FINANCIAL SECTOR AFTER THE CRISIS IN THE EUROPEAN UNION

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Taxation of financial sector is an important issue of the actual fiscal policy, especially after the economic crisis impact. By taxing the financial sector, it is intended taxation of financial transactions, and financial activities. European Union supports the taxation of the financial system and makes proposals in this regard. This paper tries to reveal the major aspects concerning the taxation of financial sector, both theoretical and empirical aspects. It will analyze the reasons which justify the application of such taxes, but also difficulties involved in practice. Another major objective of this paper is to examine the role of taxation in the financial sector as important regulatory instrument. This subject is debated in European Commission papers and by many economists. There are underlined the necessity of such tax, the impact and the economic efficiency. Our purpose is to identify if this kind of tax is good for our economy and what can be the impact from budgetary point of view. For finding this answers the paper realize a complex analysis of the types of taxes applied on financial sector in countries which already adopted this kind of taxes, like United Kingdom, Austria, Hungary, Cyprus. We believe that the financial sector should be charged, because was responsible in great measure the economic crisis impact. A potential tax applied to financial sector is considered as an important source of budget revenues. This article tries to explore the possible tax measures for financial sector according to the major principle of public finance –equity and efficiency. Special attention will be given to the need to implement financial sector taxation in Romania. In the years before the crisis banks and entire financial sector in Romania recorded significant profits. For this reason such tax is justified given that this sector is exempt from VAT. Applying such a tax would reduce the budget deficit and on the long term will reduce the public debt.
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Introduction

The global economic and financial crisis has a major negative impact on public finance because the tax revenues are decreasing and budget deficits increases for most of all countries. In this context the fiscal consolidation requires some measures like increasing the tax rates or even introducing new taxes. As a consequence of this fact many countries (European Union member states) choose to increase value added tax rates or excises for reducing the budget deficit.

Taxing the financial sector is a current topic imposed mainly by the negative impact of financial crisis since 2008. In European Union countries, in recent years concerns the taxation of the financial sector have increased, more and more states consider implementing a taxation of financial capital for several reasons.

A potential tax applied to financial sector is considered as an important source of budget revenues. Another consideration that justifies this tax would be that the financial capital is taxed far less than consumption, labor or property. The financial sector is considered to find under-taxed compared with other economic segments because the financial activities often are exempt from VAT.

It is generally accepted that the financial sector was a major cause of the crisis and received substantial government support over the past few years. To ensure that the sector makes a fair contribution to public finances and for the benefit of citizens, enterprises and Member States, the European Commission initiated a few proposals of financial sector taxation. The financial sector had an important role in the spreading of economic crisis and the governments have to finance bank failures through fees paid by taxpayers.

In this context we can underline the major reasons that may justify the financial sector taxation:

- source of budgetary revenues;

- equity of taxation comparative with other sectors;
- regulatory instrument for correct negative externalities stemming from the activities of the financial sector, which include the effects of excessive risk-taking;
- a fair contribution of the financial sector to public finances, in particular with regard to the economic and financial crisis;

In some EU member states already operate different forms of taxation of the financial sector, with different rates. The paper realize a complex analysis of the types of taxes applied on financial sector in countries which already adopted this kind of taxes, like United Kingdom, Austria, Hungary, Cyprus. It is necessary to take measures to harmonize the taxation of the financial sector to avoid any single market imbalances.

Taxing the financial sector could contribute substantially to reducing public debt faced by many countries at this moment only if there is an effective enforcement mechanism. European Commission proposals have considered the following types of instruments, namely ***financial transactions tax (FTT)*** and ***financial activities tax (FAT)***. Financial transactions tax (FTT) will be paid on each purchase or sale of stocks, bonds or other financial instruments or when is trade one currency.

Financial activities tax (FAT) was proposed by the IMF and is a tax on profits and total remuneration of financial institutions, so that may be considered as a value-added, which is somewhat fair since financial services are not imposed with VAT.

The main cause of economic crisis was the lack of regulation and supervision of the financial sector. Taxing the financial sector could be used as a lever to regulate this sector without using direct intervention; the more effective the more powerful tax is imposed on toxic financial instruments. For this reason the financial sector taxation could be considered as a technique to solve negative externalities generated by the financial sector especially during the economic crisis, but also before and after the economic crisis.

Taxing the financial sector involves a number of practical difficulties concerning the tax rate, defining the taxable base and object, categories of taxpayers, scope and place of taxation. It is necessary a harmonized tax for EU space for avoiding migration of financial capital to countries that do not apply such taxes or have a very low rate.

Literature review

Keen (2010), makes a comprehensive analysis of current issues: imposing a tax on financial sector in terms of the role and potential implications. This fee is seen as a corrective role - "pigovian tax", which the author underline systematic externalities to which financial sector taxation can have an impact. The last years proved that it is not enough a prudential regulatory at microeconomic level, but also a macroeconomic regulatory and taxation can be used as an important tool in this respect.

Keen, Krelove, and Norregaard (2010) address the underlying rationale of the tax on financial activities and income and potential models obtained by applying the proposed fee G20 report. This fee is seen as a way to correct market imperfections and requires all long-term economic rents generated by the financial sector or only those generated in excess.

Shackelford, Shaviro, and Slemrod, (2010) propose some solutions for the implementation of new taxes on the financial sector: tax on financial transactions, taxation of bonuses and two types of taxes on financial institutions: a tax on the excessive profits and a tax on financial activities - proposed IMF (2010). These proposals are analyzed in terms efficiency considerations, and the authors anticipate these fees to be quite inefficient comparing costs it will involve large and small receipts that will bring to the budget and in terms of correcting externalities cannot identify a clear impact, because of low rates that would apply.

Buckley, and North (2011) argue that the introduction of a low level global financial transaction tax as part of an integrated policy framework would promote greater alignment between capital

market and economic activity to the real benefit of entire economies and the people who live in them. Considering the technical issues of financial transaction tax their proposal is for applying low rate initially, with an agreed review period of five years. The tax should be a small impost of between 0.005 percent and 0.05 percent. Also it is necessary some differential rates applied to instruments or asset classes to reflect the varying transaction costs and the extent to which the tax is intended to discourage trading in particular instruments or classes. The tax should be calculated on the notional values of the underlying security and should be adjusted for the term of the security.

The major benefits of the financial sector taxation are mentioned by Meussen (2011): enhancing the efficiency and the stability of the financial markets, reducing the excessive risk-taking producing negative externalities for the rest of the economy and volatility of the financial markets.

Financial transactions tax

This kind of tax it the subject of European Commission's proposals. Under these proposals we will summarize the major directions agreed by the European Commission.

Products and transactions covered are: stocks, bonds, currencies, derivatives, options, spot transactions. Chargeable event takes into account the principle of commitment (contract entry into force) or cash principle when actual payment is made or the two combined.

Place of taxation can be set differently for each jurisdiction and can be done according to the residence of the parties, the place of operation or depending on where it is issued financial instrument.

Taxable persons can be subjects or institutions arranging the transaction. The tax base is a particularly difficult concept to clarify for those financial instruments as derivative or spot. The tax can be a flat rate or differentiated. The flat enjoys the advantage that is easily applied and managed, while the differentiated rates are more complex and difficult to manage. The latest proposals were for very low rate between 0.01% and 0.1% to avoid a negative impact on markets and discourage tax evasion.

European Commission and the IMF have developed and implemented several proposals for studies on the taxation implications of financial sector. There are also studies that deal with this issue in many respects: the proposals on the application of VAT on financial sector tax to a separate application.

In the experience of EU Member States taxing the financial sector are already in place certain measures or will in the near future to take effect.

Some states have turned to tax on financial transfers. In this case are some examples. Finland applies a transfer fee over the selling price of shares at a rate of 1.6%. Greece also applies to a transfer fee of 0.2% over the shares listed. In Poland is imposed the sale of shares or derivatives of 1% of market value.

But the main drawback of financial transaction tax is underlined by Nerudova (2011). This kind of tax would generate revenues mainly in the very narrow group of states, where the big financial centers are situated. This disproportion would be further deepened by the inclusion of derivates into the tax base. It would therefore be necessary to apply the tax globally, for the investors all around the world use those financial centers and therefore all the users of the financial centers participate on the tax revenue.

The Financial Activities Tax

A Financial Activities Tax would be levied on the sum of profit and remuneration of financial institutions. The rationale for the FAT is to target specifically financial sector activities, without affecting the operations developed on financial markets. This kind of tax can be considered as a measure to limit the risk on the financial market. The question is – how fair is that financial

institution to pay an additional tax comparative with other companies? Considering the benefit principle paying taxes has to be in accordance with the benefits received from the state. If the governments have supported the banks in crisis time, then such additional tax for financial sector is justified.

Financial activity tax can applied in three different forms:

- FAT 1: as a value added tax imposed on wages and profits;
- FAT 2: as a tax on economic rents in the financial sector (paid for supernormal wages and profits);
- FAT 3: a tax levy on very high wages and profits for discourage risk taking.

European Union countries experiences

A few EU countries choose to introduce financial sector taxation in 2010 and 2011 and this trend will continue in 2012 because the increasing tax receipts represent a priority of the fiscal policy for all EU countries after the economic crisis. Countries like Hungary applied the financial activity tax since 2010 with different rates. In Austria, Hungary and Portugal, financial activity tax is implemented in the form of a bank levy based on the balance sheet total (excluding own capital and secured deposits). Also, in Cyprus, a levy on the total deposits in banks was introduced and France introduced a levy based on consolidated risk weighted assets.

Tabel no. 1. Forms of taxes on financial activity imposed after crisis in EU countries

Country	Type of taxes	Tax rates
Hungary 2010/09/27*	Special tax on financial institutions	1. credit institutions: 0.15% - 0.53%; 2. insurance companies: 1.5% - 6.4%; 3. financial enterprises: 6.5%; 4. investment firms: 5.6 %; 5. exchange market operators: 5.6% per centş 6. investment fund management companies 0.028%.
UK 2011/01/01*	The Bank Levy	The standard rate was originally set at 0.075%, but it was raised slightly in March to 0.078%, and again, to 0.088%, from January, 2012.
Cyprus 2011/04/29*	Special tax for financial institutions	0.095% of the deposits held in Financial Institutions restricted to a maximum of 20% of the total taxable profits of the Financial Institution
Austria 2011/01/01*	Levy on banks	The levy is structured progressively, with a rate of 0 per cent for the bracket up to € 1,000 million, 0.055 per cent for the bracket up to € 20,000 million, and 0.085 per cent for any amount exceeding this threshold.

*Note: Date of introduction

Source: realized by author based on European Commission on-line database Taxes in Europe

Denmark increased its financial activity tax (FAT) in 2011, which is a duty on wage and salary costs for businesses engaged in financial services. The rate was raised from effectively 9.13 % to 10.5 %.

In the United Kingdom the financial sector has a major contribution to the economy and for this reason a special attention was given to the taxation issue. The most important measure was introducing, both a bank levy and a one-off bank payroll tax (i.e. bonus tax) of 50 % on bonuses over £ 25 000 paid by banks and building societies between 9 December 2009 and 5 April 2010.

The purpose of the levy bank is to ensure that the banking sector makes a fair contribution, reflecting the risks they pose to the financial system and the wider economy. Another purpose is to encourage banks to move away from risky funding models that threaten the stability of the financial sector and the wider economy.
For revealing the efficiency of this tax we try to reflect the budgetary receipts of this tax in Hungary and United Kingdom. Because Hungary has applied the highest tax rates there was registered the high level of tax receipts, almost 2 % of the total revenue.

Tabel no. 2. Tax receipts from financial sector taxation in 2011

Country	**Type of taxes**	**Tax receipts as % of GDP**	**Tax receipts as % of total revenues**
Hungary	Special tax on financial institutions	0.7	1.85
UK	The Bank Levy	0.08	

Source: realized by author based on European Commission data

Some countries like Denmark, France choose to apply financial sector taxation included in labor taxation through progressive tax rates.
In countries like UK or Luxemburg the financial sector is very important because is assuring many jobs and an important part of gross domestic product. If the financial sector taxation is increase it is expected a tax receipts increase, but on the other hand also tax competition increase. Generally speaking the major financial centers have the most powerful financial capitals, but in the same time there is an alternative – tax havens - preferred just for no existing taxes.

Perspectives on taxation of financial sector in Romania

How necessary is the financial sector taxation in Romania? Our country's situation is similar with the other EU countries about the introduction of such a tax? Financial sector in Romania hasn't recorded transactions with high risk like other countries, has been more a phenomenon of contamination. Regarding financial support offered by the government to financial sector was quite lower. But as a member of the European Union, Romania has to adopt harmonized tax measures about financial sector and should apply these measures. If applied financial sector taxation the main concern of the government has to be avoiding measures that could lead to transmission of the tax burden on customers. It should also be severely taxed highly speculative risk, and operations considered toxic. Tax burden is unfairly distributed in Romania; this burden is supported by the consumers most of all, namely individuals and less by the companies. We must avoid a new burden for individuals by applying financial sector taxation. In the years before the crisis banks and entire financial sector in Romania recorded significant profits. For this reason such tax is justified given that this sector is exempt from VAT. Applying such a tax would reduce the budget deficit and on the long term will reduce the public debt.

Conclusions

This issue of financial sector taxation is and will be a controversial issue at European Union level. A possible solution is to implement a unique tax for financial activities for all EU countries with the same tax rate for avoiding financial capital migration between EU member states. It is important to implement a low tax rate because for preventing capital migration out of EU. Concerning the financial transaction tax in this case the best solution has to be choose by every state in respect with some particular characteristics of own financial sector. It is not equitable to impose the same tax or the same rules on financial transaction for all EU states because the financial sector pattern is quite different between EU member states.

In this light the European Commission considers that there is greater potential for a Financial Activities Tax at EU-level. This option could deal with the current VAT exemption of the financial sector and raise substantial revenues. Considering the innovative nature of this kind of tax there is a need for further technical work on how it might be implemented.

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