

Commentary: The Specter of a Transaction Tax Rises Again

By Stephen J Nelson; The Nelson Law Firm, LLC

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In my earliest days as a securities lawyer, deal closings that involved the purchase of securities were not consummated in New York. Instead, lawyers and bankers would take the train and close the transaction in New Jersey. During the same period, many over-the-counter trading firms relocated to Jersey City. Then, after about five years of this silliness, lawyers stopped making the trip to New Jersey to close transactions, and most trading firms returned to New York City.

The reason for this strange behavior was simple. In response to an awful fiscal crisis, New York decided to collect a tax on securities transactions. The New York and American Stock Exchanges were unable to relocate and were forced to pay the tax. The over-the-counter traders were able to pick up and move; so off to Jersey City they went. Lawyers and investment bankers are extremely flexible and will close transactions wherever their clients wish. It was cheaper at the time to pay the lawyers and bankers to take the train to New Jersey than pay the tax.

As it happens, New York State's tax on securities transactions remains on the books. To stem the flight of financial services firms to New Jersey, the tax has been suspended. But, New York corporations are required to file a card with the Department of Taxation to facilitate the collection of the tax, if it should ever be brought back to life, and there is a very nice lady in Albany whose job it is to keep track of and file these cards. Just about every year, some legislator in Albany proposes to bring it out of suspension. The notion is particularly attractive whenever the State finds it difficult to pay its bills, and we are knee deep in red ink at the moment.

A securities transactions tax proposal, sponsored by Peter DeFazio of California, was introduced in Congress early this year. Until recently, the bill had very little support. However, the AFL-CIO recently waded in with a companion proposal. Mr. DeFazio and the AFL-CIO have argued that their proposals would raise a lot of revenue that could be used to pay for infrastructure projects. In addition, the AFL-CIO argues that a securities transactions tax would discourage "high-frequency" trading, which has become the latest financial boogey man.

There is a lot of political support for taxing financial services at the moment, if for no other reason than to extract recompense for all the harm the industry is blamed

for causing to the international economy. A securities transactions tax has the beauty of simplicity. It is easy to assess and collect.

So, Congress, and for that matter, New York, would very likely impose a securities transactions tax, except for New York's unfortunate experience, which has been visited on every jurisdiction that has tried to implement it. Firms will relocate to avoid the tax. Some firms would relocate immediately to avoid the tax. Others, tied to real estate commitments, would relocate over time. In this day of global communications, most financial services firms can pack up and move in a heartbeat.

As a result, I have generally advised my clients not to worry about a securities transactions tax. However, recent developments have caused me to rethink this advice a bit.

Lord Turner, who runs the Financial Services Authority, the SEC's counterpart in the United Kingdom, recently stated that the members of the International Financial Stability Board (FSB) had expressed a determination not to let national competitiveness come between them. He specifically identified a securities transactions tax as one of those items the FSB had considered, recognizing that global regulators would have to agree to work together to make such a tax successful. Lord Turner, for his part, thinks a securities transactions tax would be a neat way of holding down profits in the financial services industry, indirectly limiting the amount of compensation the industry could pay to its employees.

The Financial Stability Board was established by the G-20 summit in London on April 2, 2009. Its purpose is to promote "cross-border cooperation" among global financial services regulators in the interests of financial stability. Representatives of the Fed, SEC and Treasury are members of the Board. Naturally, if all the G-20 members agreed to impose a securities transactions tax of similar amount, financial services firms that wished to avoid the tax would have nowhere to go, as a practical matter.

I still believe the odds are against a securities transactions tax. The G-20 members are clearly trying to work together, but the instinct to compete is strong. The competitive nature of the human species generally dooms cartels and defeats efforts to establish cooperative regulatory regimes among sovereign nations. Even the strong federal government of the United States does not prevent New Jersey from competing with New York for the business of financial services firms by offering tax incentives for relocation.

That said, the issue bears watching. Like the legendary Phoenix, the securities transactions tax is threatening to rise from its ashes.

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