For many years, no one paid much attention to the tax treatment of the financial sector. There seemed little need. It was obviously a complicated, specialized, and dull topic – and it was not obviously important. From the public finance perspective, comfort could be taken in the general principle that the tax system should not offer special treatment to particular sectors. And financial market specialists showed little interest in taxation, presuming it to be of, at most, only second order importance.

The financial crisis changed all that. With inefficiencies and skewed incentives in the financial sector clearly the root of the matter, and public discontent high, attention quickly turned not only to regulatory reform but also to the taxation of banks and other financial institutions. This began, for the first time, to receive focused and serious attention, starting with a request from the G-20 to the International Monetary Fund to suggest ways in which a ‘fair and substantial’ contribution might be raised from the financial sector. And one of the first things we found was a remarkable absence of previous thought to build on. Reflecting that, it turned out that the challenges lay less in mastering the technicalities than in sorting out the various objectives that tax and regulatory instruments might appropriately pursue and the various effects they might have.

Immediately to the fore in public debate was the idea that the financial sector should somehow pay for the difficulties it was felt to have created. At its crudest, the sentiment was close to a desire for revenge – something for which the tax system is both inherently inappropriate and ill-equipped to deliver. Another strand of thought focused on the apparently substantial rents earned in the financial sector, most obviously in the form of large bonuses – with a sense that, on both fairness and efficiency grounds, these would be a good object for taxation.

Efficiency consideration came into play more broadly too. One aim might be to cover the direct fiscal costs of government interventions in response to the crisis – and to do so, if not for the current crisis, at least for those sure to happen in the future. And the high social costs of excess leverage focused attention on the ‘debt bias’ inherent in the standard

1 Views expressed here are mine alone, and should not be attributed to the staff, executive directors or management of the International Monetary Fund.
corporate income tax: the deduction of interest payments but not of a return to equity creates a corporate level tax-incentive to use debt rather than equity finance. Even establishing neutrality between debt and equity finance might not be enough, however, given the evidently large social costs of failures or bailouts in the financial sector. Responding to these concerns, the spread of special ‘bank taxes’ of various forms – now 13 or so in the EU – has been not only the most striking tax response to the crisis but also one of the most innovative tax developments of recent years.

In addition, concerns at the distortions caused by the exemption of financial services under the VAT – over which tax specialists had been agonizing for years – also came to some prominence, and one that the IMF report sought to reinvigorate with the proposal of a ‘Financial Activities Tax’. So too did the idea of a broad-based ‘Financial Transactions Tax’. Long (and, frankly, still) unpopular with tax specialists, this acquired a new and impressive lease of political life – though one that may be now gently expiring. It also found some application, in many respects quite limited, but including, in a few countries in the innovative form of a tax on high frequency trades.

And over-arching all this is a still deeper and difficult issue. What are the proper roles of taxation and regulation in addressing the particular risks and challenges posed by the financial sector? Are any special tax measures needed at all?

This, evidently, is a complex and varied area. Mastering it calls for considering a wide range of instruments, from varying perspectives, without losing sight of how they might all fit together. The wide-ranging contributions to this book provide exactly that. They do not provide all the answers – that would be too much to ask. But they take us forward in framing and understanding the questions, and in evaluating the options. And they show too the intellectual excitement that is now to be found in an area that was for much too long relegated to the occasional, dutiful footnote.

Michael Keen
Deputy Director, Fiscal Affairs Department
International Monetary Fund