INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

Written Testimony in Opposition
filed by
Investment Company Institute
for the
October 19, 2020
hearing on
A4402 – Financial Transaction Tax

The Investment Company Institute[1]—on behalf of shareholders in all funds, including mutual funds, that are registered under the Investment Company Act of 1940 (the "1940 Act")—strongly opposes A4402. A tax on processors of financial transactions of a quarter of a cent ($.0025) per transaction (an FTT) would increase the cost of saving for retirement and other long-term needs for New Jersey residents and other individuals.

FTTs Increase the Cost of Saving

- Imposing an FTT will increase the cost of saving for retirement and other long-term needs.
- Almost half of all American households have become mutual fund investors and now depend on these investments to reach their financial goals.
- A $.0025 FTT may seem very small, but it results in multiple layers of taxation and significantly negates the benefit that falling expense ratios costs have had on investment returns.

FTTs are Poor Revenue Raisers and Harm Markets

- FTT-type taxes have historically raised far less revenue than predicted.
- Most long-term studies of FTTs indicate that they harm markets by reducing trading volume, impairing liquidity, and distorting price discovery.

Recommendation

- The Institute strongly recommends that the proposals to enact an FTT be rejected.
- At a minimum, any FTT must ***not*** be extended to1940 Act-registered funds.

---

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$26.9 trillion in the United States, serving more than 100 million US shareholders, and US$7.8 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

Background

1940 Act-registered funds are publicly offered investment pools that provide individuals with access to a diversified portfolio of stocks, bonds, or other securities that these investors cannot replicate efficiently. These funds, consequently, are very attractive investment vehicles for moderate-income investors.[2] Our capital markets have been democratized by funds in ways that could not have been imagined just a generation or two ago. In fact, at year-end 2019, funds held approximately 32 percent of US-issued equities.[3]

The typical fund investor is a middle-class American with a median household income of $100,000 and modest holdings.[4] Almost half of all American households[5] invest in mutual funds; they depend on their fund investments to buy a home, finance a child's education, support aging parents or extended family, and prepare for retirement.[6]

Application of the Proposed New Jersey FTT to Fund Investors

The proposed FTT would significantly increase the cost of transactions processed electronically in New Jersey that involve a fund's portfolio securities. To the extent that the purchase and sale or redemption of fund shares also are processed electronically in New Jersey, those transactions also would be taxed. Thus, a tax could be owed when investors purchase mutual fund shares, again as the fund puts investors' savings to work in the market, again when the fund sells shares to meet a redemption request, and taxed yet again when the shareholder redeems. This tax would apply irrespective of whether the fund or its investors are located in New Jersey.

By applying the tax only to persons or entities that process 10,000 or more financial transactions annually through electronic processors located in New Jersey, the tax may be characterized as hitting only big players. The tax, however, would be passed on to the purchasers or sellers of securities or other financial instruments regardless of how many or few transactions they make. So, a transaction involving an individual purchasing fund shares once a year would be taxed if the processor of the transaction meets the 10,000-transaction requirement.

---

[2] Retail investors (i.e., individuals) hold the vast majority (89 percent) of US mutual fund assets.https://www.ici.org/pdf/2020_factbook.pdf , Figure 3.3.

[3] https://www.ici.org/pdf/2020_factbook.pdf, Figure 2.7.

[4] The most recent ICI data show median mutual fund assets of $150,000 per household in four accounts. https://www.ici.org/pdf/2020_factbook.pdf, Figure 7.2.

[5] The most recent ICI data show 45 percent of US households owned mutual funds in 2019. https://www.ici.org/pdf/2020_factbook.pdf, Figure 7.1.

[6] The most recent ICI data show that individuals invest in mutual funds to save for retirement (92 percent), for emergencies (50 percent), and for education (24 percent). https://www.ici.org/pdf/2020_factbook.pdf, Figure 7.2.

Because fund investors are the sole owners of a fund, the investors' return is reduced on a dollar-for-dollar basis by all costs incurred by the fund. These costs would include an FTT on portfolio and shareholder-level transactions processed through New Jersey. An FTT, consequently, would increase a fund's costs and reduce the return to the middle-class shareholders who own the fund's shares.

The Proposed Tax Would Harm Middle Class Fund Investors

The bill's sponsor advocates that the FTT will raise significant amounts of revenue for New Jersey because billions of financial transactions are processed daily, many of them through electronic infrastructure in New Jersey. A substantial portion of this tax, however, would fall on the moderate-income investors in funds and would decrease their return on investment.

Investors saving for retirement have benefitted tremendously from falling expense ratios; this tax would significantly negate the benefit that reduced costs have had on investment returns. Given the increased responsibility that individuals have for ensuring their own retirement security, the legislature should be creating incentives to *encourage* rather than *discourage* saving.

FTTs are Poor Revenue Raisers and Harm Markets

Many states are facing extreme revenue declines as a result of the COVID-19 pandemic and are exploring new taxes to shore up the shortfalls. There is no evidence, however, of the purported benefits of FTT-type taxes.[7] Most studies have found that these taxes raise far less revenue than predicted and result in tremendous efforts to avoid the tax, reducing the revenue raised by the tax and perhaps increasing, rather than reducing, the resources devoted to financial engineering.

Further, most long-term studies of FTTs imposed in other countries found that they reduced trading volume, impaired liquidity, and distorted price discovery. New Jersey should not impose a tax that would hamper the functioning of the markets and hurt long-term investors. This tax could also cause the electronic infrastructure that facilitates transactions to migrate to lower-cost venues outside of New Jersey.

Recommendation

The Institute strongly recommends that the proposals to enact an FTT be rejected. At the very least, any FTT must ***not*** be extended to1940 Act-registered funds. Any such FTT would be borne by their investors—average Americans saving for their long-term needs. The unintended (and most unfortunate) consequence of this bill would be to harm moderate income Americans saving for retirement.

* * * * * * *

The Institute appreciates your consideration of our concerns. Please do not hesitate to contact Katie Sunderland (at 202-326-5826 or katie.sunderland@ici.org) if you have any questions regarding this written testimony or would like any additional information regarding the organization, operation, or taxation of investment companies and/or their shareholders.

---

[7] For more information see ICI's Financial Transaction Tax Resource Center at: https://www.ici.org/ftt