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TAXATION OF FINANCIAL SECTOR – RISK ASSESSMENT BASED ON THE EXPERIENCES OF SELECTED COUNTRIES

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Abstract:
The aim of the paper is to identify and assess the risks associated with the financial sector taxation depending on different form of taxation (e.g. bank levy on assets, liabilities or tax on financial transactions). The study is focused on such effects as the risk of passing the cost of tax on customers or employees of banks, the risk of reduction in lending, the risk of lowering the competitiveness of institutions and markets, the risk of capital outflow to countries which have not introduces this kind of tax. The paper will analyse the experiences of selected countries that have introduced various forms of taxation of the financial sector.

Keywords: risk, bank tax, bank levy, financial transaction tax, selected countries case study

1. INTRODUCTION

The financial sector taxation is being considered for a long time. The first proposals for the taxation of the financial sector were formulated by J.M. Keynes (Keynes, 1936) and J. Tobin (Tobin, 1978). J.M. Keynes argued that tax will enable a reduction the scale of speculation. J. Tobin recommended the implementation of currency transaction tax in order to limit currency fluctuations. Further works led economists such as: J.E. Stiglitz (Stiglitz, 1989), P. B. Spahn (Spahn, 1996), P. Kenen (Kenen, 1996), R. Schmidt (Schmidt, 1999).

The taxation of financial sector is being considered in various forms and different extend. The main forms of financial sector taxation are: financial transaction tax (FTT), financial activity tax (FAT) and bank levies. Literature, as well as the experiences of many countries show a different design of these taxes, which not only causes varied consequences for financial institutions, but also for budget and economies.

Among the EU Member States the two main models of financial sector taxation are used: 1) the bank levies, used in 14 EU countries, and 2) the financial transaction tax, which was introduced in 3 EU countries.

Synthetic summary of the most important features of financial transaction taxes in the EU is specified in table 1, while the characteristics of bank taxes in table 2.

Table 1: Financial transaction tax in EU member states

Country	Start date	Tax base	Rates	Exclusion from tax base
France	August 2012	equity issued by French firms with market cap > €1bn high frequency order cancellations or modifications CDS derived from EU sovereign debt	0,2% 0,01% 0,01%	primary market transactions, central securities depositories, transactions for the purposes of market making, transactions executed under liquidity agreements, intra-group transactions, temporary transfers of securities (including repo transactions), acquisition of securities under employee savings regimes, acquisition of convertible or exchangeable bonds
Italy	January 2013	equity (issued in Italy) equity traded OTC *from March 1st 2013,* high frequency trading (HFT) on equity (issued in Italy) *from September 1st 2013,* derivatives and HFT of derivatives	0,1% 0,2% 0,02% lump sum	transactions with 'institutional' counterparties, transactions for the purposes of market making, transactions executed under liquidity contracts, pension funds or compulsory social security institutions established in EU or EEA Member States
Hungary	January 2013	bank transfers, payments, direct debits, deposits withdrawals	0,3% 0,6%	transfers between accounts held at the same bank by the same person, cash pooling in bank account held by the corporations in the same financial institution, transactions between the current account and the investment account held by the same individual in the same institution

Source: PWC (2013a). *Financial transaction tax: The impact and arguments. A literature review*, 21 November 2013, act of national law.

Among the EU member states, 3 countries introduced financial transaction tax (France, Italy and Hungary) and 14 decided to introduce bank levy (Austria, Belgium, Cyprus, Finland, France, Germany, Hungary, Latvia, Netherlands, Poland, Portugal, Slovakia, Sweden and United Kingdom). The implemented models of taxation vary between countries. Liabilities or their selected items are the bases for taxation in 10 countries, while 4 countries decided to tax assets (Hungary and Poland) or risk-weighted assets (Finland and France). In addition, the United Kingdom introduced in 2016 an additional tax on banks' profits.

In 8 countries dominated the fiscal target to introduce a bank tax (Finland, France, Latvia, the Netherlands, Poland, Portugal, Hungary and the United Kingdom). In 4 countries the main purpose of the introduction of the tax was to ensure the stability of the banking sector and the revenue for a special stabilization fund (Slovakia, Sweden), restructuring fund (Germany) or the deposit guarantee fund (Belgium). Austria and Cyprus also created stabilization funds, but after achieving the target amount of funds, the revenue will contribute to treasury.

Table 2: Bank levies in EU member states

Country	Start date	Purpose	Contributes to:	Tax base	Rates	Threshold and exclusion from tax base	Deductible for CIT
Austria	2011	The stability of banking sector, fiscal	1) Special federal funds for the specific purpose of measures regarding the stability of the financial market (2012-2017) 2), Treasury	Unconsolidated balance sheet total (liabilities)	0,09% - 0,11% (> € 20 bn)	€ 1 bn allowance; Nominal capital and reserves, assured bank deposits and certain liabilities from the liquidity requirements of the Banking Act	Yes
Belgium	2012	The stability of banking sector	Resolution Fund, Treasury	Liabilities	0,035%	Nominal capital, assured bank deposit	Yes
Cyprus	2011	The stability of banking sector, fiscal	Special Fund for the stability of the banking sector, Treasury	All Deposits excluding inter bank deposits	0,15%	From 2013 Tier 1 Capital is excluded from taxable base	No
Finland	2013	Fiscal	Treasury	Total amount of risk-weighted assets	0,125%	-	No
France	2011	Fiscal	Treasury	Total amount of risk-weighted assets	0,539% (reduction to 0,141% since 2019)	€ 500 million of minimal own funds requirement	Yes
Germany	2011	The stability of banking sector	Restructuring Fund	Balance sheet (liabilities) Derivatives	0,02%-0,06% 0,0003%	€ 300 million Customer deposits and other liabilities toward non-banks. Equity capital	No
Hungary	2010	Fiscal	Treasury	Total assets	0,53%>50 bn HUF (0,31% since 2016) 0,15%<50 bn HUF	Interbank loans, loans for financial institutions	Yes
Latvia	2011	Fiscal	Treasury	Liabilities	0,072%	Nominal capital, assured bank deposit	Yes
Netherlands	2012	Fiscal	Treasury	The stand-alone balance sheet or, if applicable, the worldwide consolidated balance sheet	0,022%-0,044%	€ 20 bn allowance Regulatory capital, deposits covered by deposit guarantee	No

						schemes, insurance business related liabilities	
Poland	2016	Fiscal	Treasury	Total assets	0,44%	PLN 4 bn (banks) PLN 2 bn (insurance companies)	No
Portugal	2011	Fiscal	Treasury	Balance sheet (liabilities) Derivatives	0,01%-0,085% 0,001%-0,0003%	Nominal capital, assured bank deposit, derivatives for securing	No
Slovakia	2012	The stability of banking sector	Stability fund	Balance sheet (liabilities)	0,2% (0,4% 2012-2014)	Capital, subordinated debt securities, intragroup liabilities	Yes
Sweden	2009	The stability of banking sector	Stability fund	Sum of the liabilities and provisions	0,036%	Capital, subordinated debt securities, intragroup liabilities	Yes
United Kingdom	2011	Fiscal	Treasury	Relevant liabilities	0,21% short term liabilities 0,105% long term liabilities (reduction to 0,1% and 0,05% in 2021)	GBP 20 bn Tier 1 capital, “protected” deposits	No

Source: PWC (2013b). *Proposed bank levies – update,* May 2013, KPMG (2012). *Bank Levies – comparison of certain jurisdictions,* Edition IX, June 2012, act of national law.

Financial sector taxation is gaining more and more supporters, many countries have introduced bank levy or financial transaction tax to the national tax system and EU is considering introduction of EU-wide financial transaction tax. Therefore it is needed to be sensible of potential risks associated with the introduction of this type of tax. The study based on an analysis of the construction of taxes and the impact of their implementation in some countries will enable to identify the most important areas of risk. The aim of the paper is to identify and assess the risks associated with the financial sector taxation depending on different form of taxation (e.g. bank levy on assets, liabilities or tax on financial transactions).

The study is focused on such effects as the risk of passing the cost of tax on customers or employees of banks, the risk of reduction in lending, the risk of lowering the competitiveness of institutions and markets, the risk of capital outflow to countries which have not introduces this kind of tax.

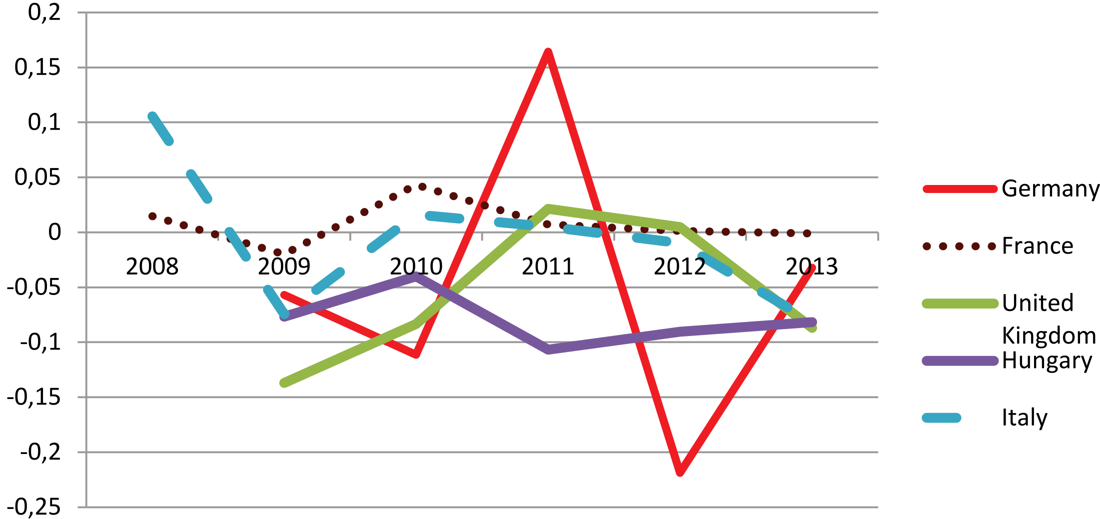
The paper analyses the experiences of selected countries that have introduced various forms of taxation of the financial sector. The selected countries are 3 EU member stares, where introduced Financial transaction tax (France, Italy and Hungary) and 4 EU member states, where introduced bank levies (France, Hungary, Germany and United Kingdom).

2. THE RISK OF REDUCTION IN LENDING

The experiences of the analysed countries show differential impact of additional taxation of financial institutions on the volume of loans and advances. The effects of introduction of bank levy were different, while the introduction of financial transaction tax resulted in decrease in the volume of loans and advances. In France, Italy and Hungary the value of loans and advances decreased after introduction of FTT. In the UK were no such changes after introduction of bank levy in 2011, when the value of loans and advances increased in 2011-2012, then declined in 2013. After introduction of bank

levy in Hungary (2010) and France (2011) there were also no reductions in value of loans and advances. A different situation took place in Germany, where value of loans and advances decreased after introduction of bank levy. Therefore, the reduction of loans and advances volume can not be unambiguously associated with the introduction of a bank levy, while the experiences of the introduction of FTT indicates the reduction in lending. The annual changes in total loans and advances show picture 1.

Picture 1: Annual change in total loans and advances (in %) in the years 2008-2013

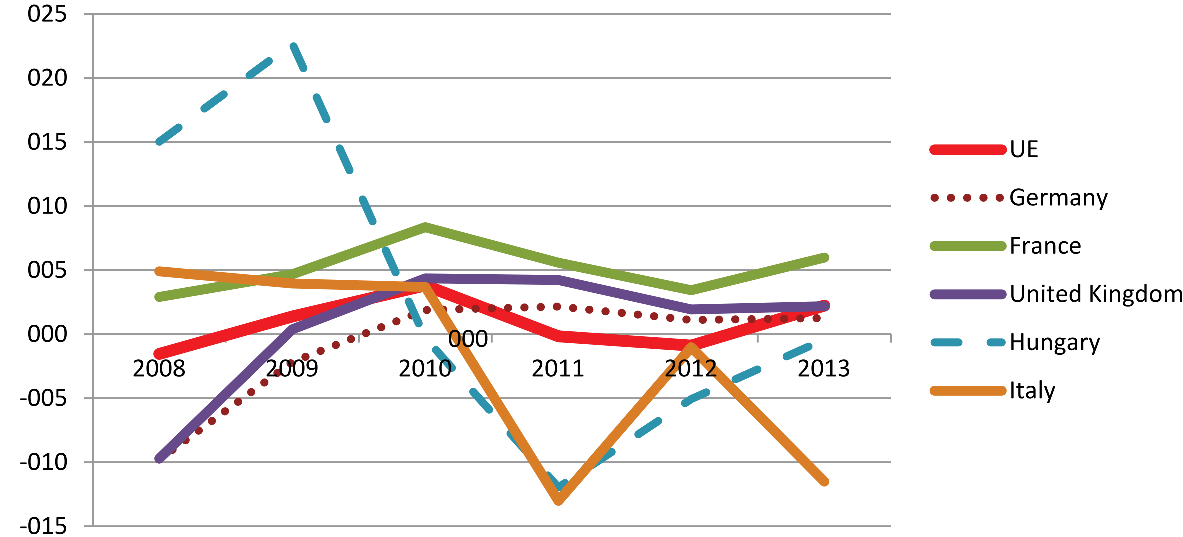


Note: Domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches.
Source: ECB, Statistical Data Warehouse, https://sdw.ecb.europa.eu (15.02.2016).

3. THE RISK OF LOWERING THE COMPETITIVENESS OF FINANCIAL INSTITUTIONS AND FINANCIAL MARKETS

Additional taxation of financial sector may have negative impact on economic growth. Taxation of financial sector could also reduce the investment attractiveness. The increase of costs can contribute to reduce the development of financial sector, which according to studies can contribute to economic growth.

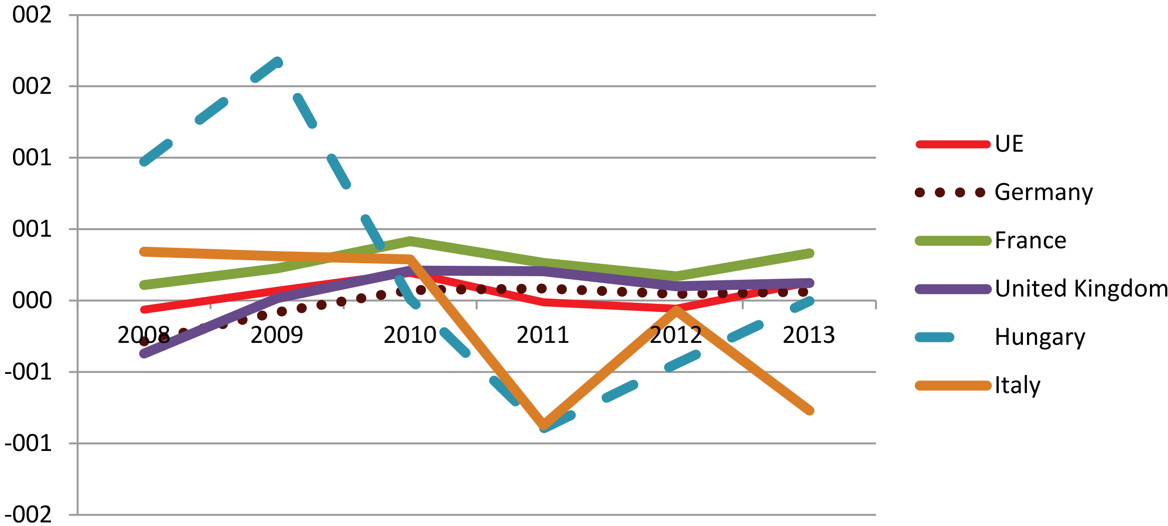
Picture 2: Return on equity in the years 2008-2013



Note: Domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches.
Source: ECB, Statistical Data Warehouse, https://sdw.ecb.europa.eu (15.02.2016).

Additional strain imposed on banks in analysed countries caused a decline in profits of banking sector. The introduction of FTT caused a decline of ROE and ROA in France and Italy, while the introduction of bank levy caused a decline in France and Hungary and an increase or stabilization in UK and Germany (Picture 2 and 3).

Picture 3: Return on assets in the years 2008-2013

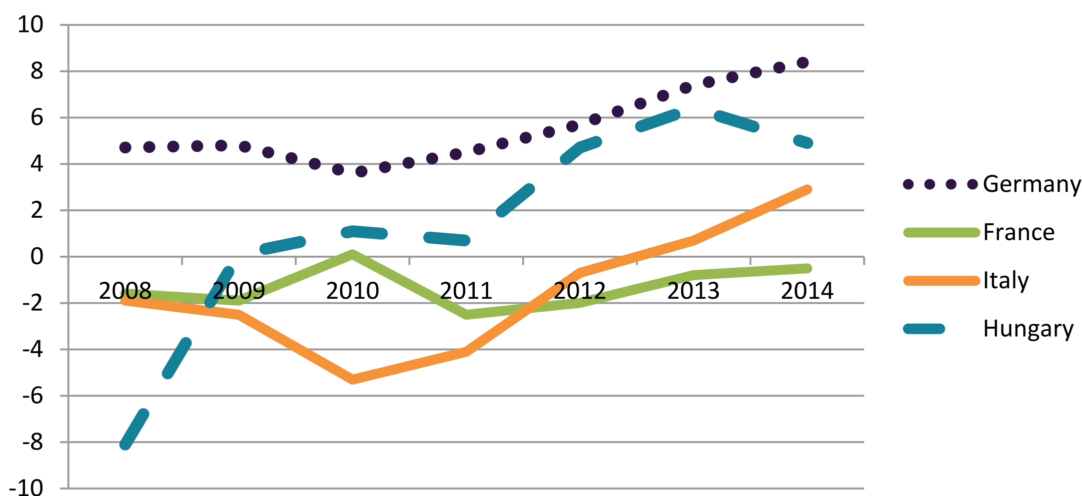


Note: Domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches.
Source: ECB, Statistical Data Warehouse, https://sdw.ecb.europa.eu (15.02.2016).

4. THE RISK OF CAPITAL OUTFLOW TO COUNTRIES WHICH HAVE NOT INTRODUCES FINANCIAL MARKET TAXATION

Based on the study can not be clearly indicate that the introduction of additional taxation of the financial sector negatively affected the balance of payment. The introduction of both bank levy, as well as the FTT in Hungary had no negative impact on the result of the financial account of the balance of payment, which was positive in 2009 and was improving in the next years. It is difficult to clearly identify the negative consequences in balance of payments as a result of introduction of bank levy in Germany: since 2011 there was capital inflow into Germany (Picture 4).

Picture 4: Financial account (net) of the balance of payments as share of GDP in the years 2008-2014



* No data for United Kingdom.
Source: Eurostat Database, http://ec.europa.eu/eurostat/data/database [bop_gdp6_q], (15.02.2016).

Statistical data do not confirm clearly the impact of the introduction of FTT on the outflow of capital from Italy, because the balance of financial account of the balance of payments in Italy in 2013 (introduction of FTT) and 2014 was positive and has been gradually improved. The balance of the financial account of balance of payments was negative in France since 2011 (introduction of bank levy), which, however, is gradually improving since 2012 (introduction of FTT).

The research shows that the taxes are not the most important factor affecting the capital flows, which ate stimulated primarily by economic factors, such as the attractiveness of investment, rate of return, safety of invested capital as well as political factors.

We should not also forget about the behavioural factors that may contribute to the outflow of capital even before the introduction of the tax.

5. THE RISK OF SHIFTING THE COST OF TAX ON CUSTOMERS OR EMPLOYEES OF BANKS

One of the most often indicated risks associated introduction of financial sector taxation is the risk of passing the cost of such taxes on customers or employees. It should not be forgotten that banks apart fulfil special features, they are enterprises whose purpose is to gain profit. Therefore, it is natural that they seek to reduce costs, including by shifting them on other entities or customers.

The research shows that in all considered types of financial sector taxation is possible to shift the economic burden of the tax to customers or employees. The construction of this type of taxes makes it possible to shift the burden of taxes as a higher interest rates or commission. In addition, it is difficult to find sufficiently effective formal or legal tools, which could prevent such shifting of taxes. Only the market mechanism and an appropriate level of competition on the market can reduce the scale of shifting taxes.

6. SUMMARY

More and more countries are considering introduction of additional financial sector taxation. Among the EU member states, 3 countries introduced financial transaction tax (France, Italy and Hungary) and 14 decided to introduce bank levy (Austria, Belgium, Cyprus, Finland, France, Germany, Hungary, Latvia, Netherlands, Poland, Portugal, Slovakia, Sweden and United Kingdom). The key arguments put forward in support of additional financial sector taxation are: fiscal target and new source of budget revenue, ensure the stability of the financial sector, aids recovery from financial crisis, compensate for VAT exempt status, reduces the profitability of criticised investment behaviour etc. (PWC (a), 2013, p. 5).

Besides highlighting the advantages and purpose of additional financial sector taxation, it should be also analyse the risk associated with the introduction of that taxes. Therefore, the study is focused on such effects as the risk of reduction in lending, the risk of lowering the competitiveness of institutions and markets, the risk of capital outflow to countries which have not introduces this kind of tax and the risk of passing the cost of tax on customers or employees of banks.

The experiences of analysed countries show that the introduction of FTT causes a decrease in the value of loans and advances, while the introduction of bank levy causes a decreased in the value of loans and advances only in one analysed country (Germany), while in other analysed countries (UK, France, Hungary) there were no such changes after introduction of bank levy. Therefore, the reduction of loans and advances volume can not be unambiguously associated with the introduction of a bank levy, while the experiences of the introduction of FTT indicates the reduction in lending.

The introduction of additional financial sector taxation could also cause the risk of lowering the competitiveness of financial institutions and financial markets. Taxation of financial sector could also cause the increase in costs and decline in profits. The impact on profitability was varied between countries, the decline of profitability after introduction of FTT took place in France and Italy, while the introduction of bank levy caused a decline in France and Hungary and an increase or stabilization in UK and Germany.

Based on the study can not be clearly indicate that the introduction of additional taxation of the financial sector negatively affected the balance of payment. The capital outflow occurred in France (2011), but from 2012 there was an improvement. The introduction of financial sector taxation had no negative impact on the result of the financial account of the balance of payment in Germany (2011), Hungary (2010 and 2013), France (2012) and Italy (2013).

The main risk associated with the introduction of financial sector taxation is possibility to shift the economic burden of the tax to customers or employees. This risk could occurred in all considered types of financial sector taxation. In addition, it is difficult to find sufficiently effective formal or legal tools, which could prevent such shifting of taxes.

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