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# GROWTH, FINANCE AND REGULATION

**SPECIAL TAXES IN BANKING**

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**Keywords:** Bank tax, financial crisis, models of bank tax, bank assets, anti-crisis instrument

**Abstract:** This article applies to the proposed introduction of a special bank tax, which is currently under discussion in both Europe and the USA. The paper observes the possible models of such a bank tax. It describes several types of bank tax, which has already been introduced in some countries; discusses whether this is actually an anti-crisis instrument, and characterized the key works that take place over such a tax in the European Union.

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## Introduction

The financial sector and banking in the European Union, as in most developed countries, was hit in recent years by great financial crisis. Many European countries were forced to spend huge public funds to rescue the commercial banks. In such atmosphere it has become an increasingly discussed the issue on creating a special bank tax in order to establish a special fund from which funds will be earmarked for their rescue in the future.

For many years banks in European Union have obligatory encumbrances, which enterprises from other sectors hadn't. These encumbrances include obligatory financial reserves in central bank, provision for deposit guarantee system, obligatory charge for to the maintenance of financial supervisory commission. Despite this, due to the financial crisis, the bank tax was implemented in the European Union countries over the past two years.

There is a doubt - if banking sector which was impaired in financial crisis - is able to manage this new encumbrance. It is quite obvious that costs of new tax will be paid by customers. And, evidently, the increase of credit prices in European Union will not contributive to the growth of economy. The main objective of this paper is to evaluate the advisability of introducing a bank tax in the European Union.

## Bank tax models

In 1978, Tobin proposed a tax on transactions in foreign exchange markets, offering a rate of 1% of transaction value. By the idea the tax should discourage market participants to buy currencies in response to slight changes in rates; in turn, a reduction in the volume of transactions should reduce the volatility in

currency markets. Though the Tobin tax was proposed to cover currency transactions, it is considered as more general concept related to different financial transactions (Palley, 2003). Tobin tax has become the basis for the formulation of various projects concerning taxation of financial assets in different countries.

It is very likely that there would be no discussion on how the taxation of banks or financial institutions, if the world is not so much surprised the financial crisis of 2008 and the subsequent wave of bankruptcies and serious problems of many banks (both giants and the smaller ones). Issues of anti-crisis measures and the creation of special tools for this are in the foreground. In many studies and publications experts provide various kinds of models of taxation of financial institutions, including the banks (Dec and Masiukiewicz, 2011).

There are three main approaches to the issue of additional taxation of banks in recent years: financial transactions tax (FTT), financial activity tax (FAT), and financial stability contribution (FSC levy)

The FTT, which includes the assumption of a specific part and the size of financial transactions carried out, affects virtually every financial institution. The structure of the FAT is very consistent with the VAT (from the payment of which banks are basically exempt). Taxing sums of profits and wages will mainly reduce the scale of the banking sector. This tax option does not effectively eliminate the most risky transactions. Therefore, there is not sufficient belief that FAT provides a positive impact on the stability of the financial sector. The basis of FSC levy is the total assets/liabilities of a bank or financial institution. FSC, as tax on financial institutions' balance sheet, in the assumptions of the IMF should be the best policy option to reduce systemic risk in the financial sector. As supposed, through this it would be possible emergence appropriate financial resources to rescue and help these financial institutions.

### **New proposals in the European Commission**

In May 2010 the European Commission presented an initiative to introduce the bank tax supposed to cover the costs of liquidation of collapsing banks in the EU. It was suggested to be a uniform tax introduced after general EU consultations. The actions undertaken by the European Commission were delayed due the prior introduction or well advanced work on the tax in individual member states, e.g. in Sweden or Germany. The activity of the European Commission referred to the EU plan to manage future financial crises. The new bank tax according to the concept must be fixed on the basis of bank assets, liabilities or profits. The detailed methodology of its calculation was postponed.

The initiative of the European Commission assumed the establishment by the EU member states so-called bank resolution national funds operating on the basis of generally accepted principles. The funds will have to make up a network and receive money from the bank tax, and the means acquired in this way should be used to comprehensive resolution of problems resulting from bank bankruptcies appearing within the EU area. It is believed that the

mechanism makes possible to curb the crisis and also to avoid a sudden sale of bank assets.

The initial proposals assumed the amount of funds at the level of 2-4% of GDP. However, Michel Barnier, EU commissioner for Internal Market and Services, claims that the funds arising from bank taxes should not be a kind of insurance policy for banks in trouble (European Union, 2010/2012). The primary goal of these activities is to protect taxpayers against budgetary sponsoring of recovery plans of banks in a difficult situation caused by a crisis. The fund will also mitigate the domino effect in the sector after the collapse of one bank. According Michel Barnier the financial sector itself should bear the cost of bank crises in the future (European Union, 2010/2012).

The proposal of the European Commission concerning the imposition of bank taxes was politically supported by the European governments on 17 June 2010. According to the European Council: "... member states should introduce a system of contributions and taxes imposed on financial institutions so as to ensure the equal burden and determine stimuli to minimise the systemic risk" (NBP, 2010). Next, the European Commission dealt with the harmonisation of the principles of approaching the bank tax. According to the European Commission there was a risk of violating the principle of fair competition in the situation of the lack of coordination in the introduction of regulations on tax collection from some institutions involved in trans-border business. One bank could be taxed a number of times. The proposals of the Commission of the summer of 2010 assumed the following principles and conditions:

- the bank levy will be an element to create the crisis management framework
- detailed issues like the purpose of introduction, the scope or the calculation base will be agreed on by the whole Union
- the tax base will be credit institutions' liabilities reduced by the deposits under guarantees and the bank own capital; guaranteed deposits are excluded because they are insured by the guarantee systems (e.g. in Poland by the Bank Guarantee Fund), and bank own capital would be excluded because its main goal is to absorb losses in business entities
- the subject scope of taxes reflects the responsibility for supervision and crisis management; it is essential to avoid the risk of double taxation of the same bank operating in several EU countries at the same time
- the necessity to calibrate taxes on banks so that they would not build too heavy burdens for them
- carrying out regular reviews of taxes with respect to their connection and complementarity with other regulations, including tax regulations.

On 20 October 2010 the European Commission presented another outline of the *Framework for Crisis Management* to take effect in financial institutions. The European Commission followed the principle that no bank is too large to collapse. Having learned from the sad past experiences, the EU authorities did not resign from introducing regulations aimed at the improvement of the security of the financial system in the future.

The European Commission in the *Framework for Crisis Management* in financial institutions does not resign from the idea of a joint bank fund for all member states, financed from the new tax. In relation to the Communiqué of

20 October 2010, the European Commission announced on 6 January 2011 the beginning of the procedure of consultations on technical details concerning the framework for the crisis management for financial sector (European Commission, 2011a). The Commission hopes to present a complex proposal of the new regulations on the proceedings in relation to collapsing banks.

On 28 September 2011 the European Commission after numerous meetings and consultations made Proposal for a Council directive (European Commission, 2011b) on adopting FTT in the European Union. According to the plans the new tax starts to apply from the beginning of 2014 years in all 27 countries that are members of the Community. If the new tax proposal gain general acceptance, the estimated proceeds from it would make up around 55 billion euro per year. According to the plans, some of this amount will be transferred to the EU budget as the new source of income, the rest of the proceeds will be fed into national budgets.

The essence of action of a new tax act is as follows:

- be levied on all transactions
- applies to transactions in financial instruments
- transactions carried out by financial institutions
- at least one of the parties engaged in transactions is established in the European Union
- tax will not be for individuals and businesses
- trading in shares and bonds will be taxed at a rate of 0.1%
- trading in derivatives will be taxed at a rate of 0.01%.

Plans to introduce a new tax on financial transactions were met with the fierce reaction of financial institutions and business with the City of London, by which it is almost an attack on their sovereignty and independence. By the new tax would suffer also companies seeking to protect themselves against uncertainty in the market (i.e. by conducting cross border financial transactions).

The proposed tax on the financial transactions will be presented before the G20 summit to set an example and incentive for other countries to introduce similar measures. The main expectations are here to the U.S., but President Barack Obama has consistently refused to adopt such a tax.

A week after the presentation by the European Commission proposed a new tax on financial transactions. Commissioner Algirdas Semeta (European Parliament, 2011) said that the time has come to the financial sector more involved in stabilizing the financial system. It should also further reduce risky practices used so far by some financial institutions. According to Semeta proposed new tax on financial transactions could force most of the financial sector companies to rethink models of their transactions, which have not yet been adequately controlled by the tax authorities.

In December 2011, Director of European Commission Directorate General for Taxation and Customs Union, Dr. Manfred Bergman presented in Poland to the public a more concrete proposal for introduction of an EU tax on the financial transactions (FTT) expected to take effect from 2014. As previously announced, the tax will apply to all financial institutions and, therefore, funds,

insurance companies, leasing, brokerage houses. Taxes should not cover individual investors, e.g. trading shares.

By presenting a proposal for introducing a new tax, Manfred Bergman said that, the tax will be at very low levels, even in the height of tenths or hundredths of a percent. Financial institutions would pay 0.1% transaction tax on the value of stocks and bonds and 0.01% on derivatives. Each country will be able to raise it himself in its sole discretion. Most importantly, the new financial transactions tax will be paid by both the buyer and the seller. However, it would not be covered by new issues of stocks and bonds

The European Commission also wants to protect the European market before the outflow of financial institutions to countries where such a tax will not apply. If they trade with each other two entities in two countries of the Union, each would pay tax on the transaction to its budget, according to the current rate in his country. If the international financial transaction is made by EU institution with another non EU institution, then both should pay tax to the European country.

Proceeds from bank tax are estimated to be about 60 billion Euros per year, so no doubt it will be a significant boost to the budget of the European Union. The Commission does not imply negative effects of such a new tax burden on financial institutions. However, a new tax on financial transactions has limits in persuading financial safety and stability targets. It is worth noting that so far have been imposed on the banking sector specific regulations (reserve requirements, capital requirements), whose main task was to increase the safety of financial institutions. It is very doubtful that tax on financial transactions is effective for preventing financial stability on markets. Mechanism of security assistance to individual banks seems to be very vague at the present. One thing, however, is almost certain, after introducing a new tax on financial transactions many global companies would move their operations from EU market to Asian countries.

### **The review of bank tax (or projects) in some European countries**

Expectations of additional taxation of banks or introducing a tax on financial transactions occurred in recent years in many European countries. This was caused not only by the financial crisis that began in 2008 and put many financial institutions in difficult position. European governments have become more focused on financial markets with the intention to stabilize financial markets and reduce potential risks in this sector. The Table 1 shows selected initiatives on introducing a special bank tax or financial transactions tax in several European countries.

Discussions on the introduction of a bank tax in Poland are already in progress for several months. The government issues new proposals to initiate such a new tax burden for banks. The bank tax may cause very negative impact on the activities of banks and significantly affect their profitability. Banks in Poland are among the most taxed institutions in the country, as beyond the usual taxes they are required to pay the fees of the Bank Guarantee Fund. A further stage reached in the European tax on financial transactions is already

so high that it should refrain from making national decisions until the completion of the introduction of such a tax in the European Union.

Poland recently conducted studies and simulations of a bank tax. According to one such study, conducted by the Polish National Bank taxation of banks is virtually a foregone conclusion. Restructuring fund would be established to manage the Bank Guarantee Fund. The tax base (for a new tax) was determined as the value of banks' liabilities minus equity and guaranteed deposits. It was assumed that the two tax rates in effect at 0.04% and 0.07%. The tax base amounted to PLN 634 billion. The study produced the following results - tax revenues would be based on rates for tax PLN 254 million and 444 million PLN. While the new tax would represent 4.3% of bank in gross profit in the event rate of 0.07% and for the 0.04% tax rate would be 2.4% of gross profit (Kasiewicz and Kurlinski, 2012).

TABLE 1. BANK TAX, FINANCIAL TRANSACTION TAX IN EUROPE

Country	Synthetic characteristics of the proposals and legislative actions
Austria	Effective from January 1, 2011. Established the following progressive rates: 0.055% for amounts between €1 billion and €20 billion and 0.085% for amounts over €20 billion. Derivatives will be taxed at 0.013% of the tax base. For the tax base will be used unconsolidated balance sheet of the bank. Will be considered the nominal amount of all derivatives reported on the trading book and of all short option positions. Bank tax will be covered such institutions as domestic banks, foreign branches of domestic banks, branches of foreign banks, brokers dealers.
Great Britain	Imposed a tax on banks in 2011 as one of the tools to reduce the budget deficit. Proceeds of the tax saving flow into a special fund assigned to assist in the future in debt and threatened banks. The tax will affect the banks whose liabilities exceed 20 billion pounds with the following assumptions: <ul style="list-style-type: none"> <li>- the liabilities of bank groups in Great Britain and building societies will be evaluated at the consolidated level</li> <li>- liabilities of British banks operating within non-bank groups will be included</li> <li>- liabilities in aggregated balances of subsidiaries, foreign banks' branches and bank groups will be included</li> <li>- the tax concerns parent banks, their branches, subsidiaries, foreign banks subsidiaries and foreign banks' branches.</li> <li>- Tax rates have been set as follows: <ul style="list-style-type: none"> <li>- at 0.04% on bank liabilities in 2011, whereas in the period of 2012-2015 at 0.07%</li> <li>- in relation to the sources of funding acquired on the interbank market with maturity not longer than 1 year, there will be a rate reduce by 50% i.e. 0.02 % in 2011 and 0.035% from 2012</li> </ul> </li> </ul>
Belgium	Introduced in 2010 special taxes on financial institutions - banks, brokerage, insurance in 2010. With such financial inducements had to be created a special fund, separate in the state budget. The tax is calculated on the amount of deposits of banks and brokerage firms at the basic rate of 0.15% and the total value of qualified insurance policies in case of insurance companies. There are two parts of the tax: <ul style="list-style-type: none"> <li>- entry Fee concerning banks and partnership brokers raised by 10 bps,</li> <li>- annual Tax assumed to rise by 15 bps.</li> </ul>
France	Introduction of a new bank tax in 2011. Revenue from this tax to the state budget estimated at approximately EUR 400 million in 2011. Bank tax will be calculated risk-weighted assets at a rate of 0.25%The new tax will concern only banks: <ul style="list-style-type: none"> <li>- French bank groups and foreign banks subsidiaries will pay the tax at the consolidated level,</li> <li>- foreign bank branches operating on the French market will be exempt from the tax.</li> </ul>
Portugal	Came into force from January 1, 2011. Paid to the state budget by domestic banks, Portuguese branches of credit institutions domiciled outside the EU. The basis for tax calculation is total liabilities, and the notional amounts of financial derivatives entered into by the credit institution. Total Liabilities subject to a rate of 0.05%, while the notional amount of financial derivatives subject to a rate of 0.00015%.

Sweden	Taxation of banks in force in Sweden since 2009. Income from tax special fund bank stability, the aim is to support the actions necessary to mitigate the risk of significant distortions in the Swedish financial system. - the revenues come from the stability tax transferred by banks, credit institutions and also other levies connected with the support of the public sector like state guarantee charges. The stability tax is levied on parent banks operating in Sweden, foreign banks subsidiaries based in Sweden and parent banks branches operating outside Sweden. Bank tax is calculated on the amount of liabilities reduced by the initial capital and also some subordinated debt securities. The annual bank tax rate in Sweden amounts to 0.036%. (in 2009 and 2010 it was reduced by half).
Germany	Bank tax receipts will be fed a special restructuring fund, whose main objective will be to support corrective action in the banks of strategic importance for the German economy. The bank tax will concern parent banks operating in Germany, their branches based outside Germany and foreign banks' subsidiaries operating in Germany. Foreign banks' branches operating in the German Republic are not levied with tax. The tax base will be the liabilities reduced by the bank own capital, guaranteed liabilities in relation to clients, and also derivatives nominal value. The amount will depend on the scale of the operation of the bank. The following progressive scale has been established: - 0.02% on liabilities below EUR 10 billion, - 0.03% on liabilities from EUR 10 to 100 billion, - 0.04% on liabilities above EUR 100 billion.
Hungary	In order to reduce the excessive taxation of the bank, it was decided that the tax cannot exceed 15% of net profit. It is important that banks are not showing profits are not exempt from paying tax. In such cases, banks will be required to pay 5% of the amount of the bid. Introduction a bank tax in 2010. The tax concerns banks, credit institutions, insurance companies and other institutions rendering financial services. Characteristics of the bank tax: - banks pay 0.15% of net assets, if the assets do not exceed 500 billion forints, and 0.5% on this part of assets that exceed the limit, - insurers are levied with the rate of 6.2% on the adjusted insurance income, - in financial firms the rate amounts to 6.5% on interest incomes and incomes from charges and commissions, - investment firms and venture capital firms pay the rate of 5.6% on adjusted net incomes, - investment fund managing companies pay the rate of 0.028% on the net value of the managed assets.

Source: NBP, 2010. Wybrane aspekty dodatkowego opodatkowania banków w kontekście debaty na forum europejskim, Narodowy Bank Polski, Warsaw, November; KPMG 2011, Proposed bank levies-comparison of certain jurisdictions, KPMG, November 2011.

In March 2012, the Ministry of Finance in Poland proposed the latest draft law on the introduction of additional charges on banking activities (Ministry of Finance, 2011). Minister of Finance in Poland assumes that the new fee will take effect as early as 2012. Assumed fee from banks, known as the so-called stability levy would be paid into the set, a special stabilization fund, which would function under the Bank Guarantee Fund. Grounds on which banks will be forced to pay the levy will be set differently in relation to domestic banks and branches of foreign banks that operate in Poland. Deadline for payment of levy determined twice a year, on the first date to July 1 of each year and the second term to 31 December each year. It is worth noting that the levy, which will be paid by the banks, it cannot be known to the deductible. Stabilization fund, which will be powered by the proceeds from the new fees will have the funds earmarked for financing emergency aid provided by the Bank Guarantee Fund, in the form of provision of guarantees to banks raising their own funds, so-called recapitalization guarantees. This will be done by acquiring the stabilization fund bonds, shares of domestic banks or bank securities. The fund will be able to provide such a guarantee to individual bank recapitalization solely at the request of the minister responsible for financial institutions. The bank, which will apply to the Bank Guarantee Fund for the guarantee of the recapitalization, will have to pay a commission on such a guarantee. This amount will be increased revenue fund.



## Conclusion

Banks held today a number of public and legal burdens, additional to the generally applicable taxes: e.g., charges on deposit-guarantee fund, contributions to the maintenance of financial supervision and reserve requirements. Thus, decisions about the next load of special taxes should be well considered and prepared.

Special taxes (including bank charge - levy) have many defects, which are frequently noted in the official national and EU discussions. Particularly critical of the financial transactions tax (FTT) as having no effect on the level of risk, and negatively affects the development of the sector. This is even more disturbing that such a tax not only could worsen the condition of many banks and financial institutions, but also would help to move their headquarters (and thus a way to escape) from our, European financial centers to similar centers in Asia. From the viewpoint of the criterion of systemic risk mitigation, the bank levy is suggested as the most reasonable option enhancing allocation of funds for the repair of the restructuring of banks.

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