

Global Financial Services

Bank levies – an update

In light of bank tax or levy proposals from several countries, as well as supranational bodies such as the EU and the IMF, this bulletin gives an update on the status of the proposals from the UK, Germany, France, the US and Hungary.

Background

As the hangover from the financial crisis lingers on, and governments face fiscal deficits and a public looking for assurances, the popularity of a bank tax or levy is easy to understand. Despite resistance from the banking community, bank levies are looking more and more probable. The likelihood of a coordinated bank tax across multiple countries remains in doubt as disagreements persist around the scope and use of the proceeds, and uncertainty remains around relief for amounts that are taxed by more than one levy.

Activities to date

The concept of a tax targeted on a specific industry or activity is not new or innovative, but the current focus on the banking sector started with comments in late 2009 from the International Monetary Fund (IMF) regarding banks incurring fees to fund future rescues in the sector. In January 2010 President Obama proposed a Financial Crisis Responsibility Fee “to be imposed on major financial firms until the American people are fully compensated for the extraordinary assistance they provided.”

In April 2010 the IMF issued its interim report, as requested by the G20. The report outlined a range of options available to countries on how the financial sector could make a contribution toward paying for government interventions in the banking system. Two specific options were mentioned. The first, a levy labelled a Financial Stability Contribution (FSC), is intended to be based on the relative “riskiness and systeminess” of the institution, such that the greater the risk posed to the financial system by the institution, the larger the assessment. The FSC is similar to many of the existing proposals, in that it takes a balance sheet or liability approach as a base for the levy.

The second option proposed was a Financial Activities Tax (FAT), to be based on profits and remuneration. Recent bonus taxes and windfall profits tax proposals are examples of this alternative. The IMF report highlighted the need for alternatives that both bear the cost of future failures, but also discourage behaviours that may make a future crisis more likely.

In May 2010 the European Commission (EC) proposed the creation of preventative funds, based broadly on a ‘polluter pays’ principle, to create “a system which ensures that the financial sector will pay the cost of banking crises in the future”.

Shortly after the EC proposal, Germany, France and the UK issued a joint statement to introduce a bank levy based on banks’ balance sheets, indicating banks must “make a fair and substantial contribution towards paying for any burden associated with government intervention to repair the banking system or fund resolution in a financial crisis” and that “all three levies will aim to ensure that banks make a contribution to reflect the risks they pose to the financial system and the wider economy”.

With all this momentum, the G20 Toronto summit in June 2010 presented an opportunity for member states to agree on a consistent and coordinated bank levy, but during the summit the difficulties with this became apparent. Countries such as Canada and Australia, whose banks weathered the crisis relatively well, disagreed with the concept, not wanting to penalise banks that did not require government support. Further disagreements related to administration of the proceeds persisted; some countries advocated the creation of a resolution fund that would be held in reserve and used to resolve future crises, whilst others were in favour of adding the proceeds to respective treasuries in order to reduce already soaring deficits.

As a result of these disagreements the G20 has not advocated a coordinated bank levy; however this has not prevented countries from implementing their own regimes. The possibility of coordination on consistent application is still evident though, shown by the joint statement issued by Germany, France and the UK.

Recent developments with respect to the European Union (EU) re-emphasised the challenges of coordination as finance ministers failed to reach agreement, remaining divided on the issue of how to administer the proceeds. Regardless, the EU Commission indicated it still plans to propose EU-wide bank levy legislation next year.

Proposals: UK

The Emergency Budget announced on 22 June 2010 introduced a bank levy that is intended to encourage banks to move away from short-term financing of long-term assets, considered by many to be a significant contributor to the banking crisis. The UK Government requested comments on administering the levy through its consultation process, which closed on 5 October 2010.

Scope

As proposed, the levy would apply to:

- the global consolidated balance sheets of UK banking groups and building societies;
- the aggregate subsidiary and branch balance sheets of foreign banks and banking groups operating in the UK;
- the balance sheets of UK banks in non-banking groups.

Liabilities of non-banking members of banking groups are also required to be included in the base.

Smaller banks, with relevant liabilities of £20 billion or less, would not be taxed under the levy; however it should be noted this is not an exemption but a threshold.

Base

The levy would apply to total liabilities (both long and short-term), but excluding:

- tier 1 capital;
- insured retail deposits (including deposits that are subject to an explicit government guarantee);
- repos secured on sovereign debt (which may be extended to similar "high-quality assets");
- policyholder liabilities of retail insurance businesses within banking groups.

Rates

An initial rate of 0.04% (rising to 0.07% in 2012) will apply to relevant liabilities.

A reduced rate will apply to longer-term funding (maturing in more than one year) of 0.02%, rising to 0.035% in 2012.

Effective date

The levy will apply to balance sheet dates from 1 January 2011. For balance sheet dates with a non-calendar year-end, the liability will be reduced for the portion of the year falling before 1 January 2011.

Other key considerations

- Netting would apply to derivatives (netting is being considered for other items as well e.g. repos).
- Intra-group funding is treated as short-term unless it can be traced to external long-term funding.
- To the extent the levy overlaps a levy of another country relief under a double tax treaty would not apply, although bilateral agreements to address double taxation are, in some cases, being discussed.
- The bank levy will not be deductible for corporate income tax purposes.
- In contrast to IMF comments, the levy is being labelled as a contribution made by banks to the UK Treasury reflective of the economic risk their activities pose, rather than insurance against a future crisis or the creation of a resolution fund.

Proposals: Germany

Germany's bank levy proposal was recently approved by Chancellor Merkel's cabinet and passed on to parliament for debate and approval. This annual levy will be based on both balance sheet liabilities and the volume of derivatives.

Scope

As proposed, the levy would apply to all credit institutions which:

- hold a banking license **and**
- are subject to the Ordinance on Accounting of Credit Institutions.

From a foreign perspective, the levy will be charged to credit institutions that are:

- subsidiaries of foreign parent credit institutions, or
- branches of foreign parent credit institutions domiciled outside the European Economic Area (EEA) under the German Banking Act.

Branches from EEA countries operating under an EU passport would not currently be subject to the bank levy.

Base

The levy would apply to the relevant liabilities of a bank, defined as the balance sheet liabilities, but excluding:

- liabilities to customers, and
- liable capital (presumably the bank's regulatory capital).

Rates

A rate of 0.02% will apply to the relevant liabilities not exceeding €10 billion, 0.03% will apply to the next €90 billion, and 0.04% will apply to relevant liabilities in excess of €100 billion.

Derivative volume contribution is at 0.00015% of the notional amount outstanding.

The annual levy will be capped at 15% of the banks most recent annual net profit.

However, at a minimum, banks will be required to pay at least 5% of the annual levy as calculated based on relevant liabilities and derivative volume.

Effective date

We understand the effective date may still be under discussion during the parliamentary debates, but if approved by the end of 2010, the levy will apply to balance sheet dates from 31 December 2010.

Other key considerations

- The annual levy will not be deductible for corporation and trade tax purposes.
- The levy will go toward the creation of a new fund that would be used in the event of a future crisis.

Proposals: France

The Finance Bill 2011, made available on 29 September 2010, sets out details of a new bank tax which is to be introduced in France.

It is hoped that, in addition to helping to tackle the fiscal deficit, the bank tax encourages financial institutions to better manage their risk.

Scope

Broadly, the financial institutions which will fall within the scope of the bank tax will include:

- credit institutions ;
- investment companies other than portfolio management companies
- market/exchange operators ;
- members of clearing houses ;
- persons agreed to manage activities of conservation or management of certain financial instruments;
- payment institutions ;
- financial companies and mixed financial holding companies.

Certain institutions will fall outside the scope of the tax, including:

- institutions which have a registered office located in another member state of the EEA, which manage their business activities in France exclusively through a branch or under the freedom to provide services rules;
- institutions with equity of less than €500m, as determined during the previous tax year.

Base

French banks will be subject to the bank tax on their worldwide business activities. By contrast, foreign financial institutions (if they are inside the scope of the tax) carrying out business activity in France will only be subject to the bank tax to the extent of their French business activities.

The taxable basis is made up of the equity required by the Authorities to respect their ratio in accordance with Basel II standards (provided by the Code Monétaire et Financier - CMF), and specified during the previous calendar year.

Rate

The rate of the bank tax will amount to 0.25% of the taxable basis.

Effective date

It is anticipated the tax will apply to the 2010 year end accounts, with the first return filings in 2011.

Other key considerations

- The bank tax will be deductible for corporate income tax purposes.
- A tax credit may be available where a parent resides in a country with a similar tax.
- Fund entities (e.g. hedge funds or securitization vehicles) will remain outside the scope of the tax.

Proposals: US Financial Crisis Responsibility Fee

Despite the announcement by President Obama in January 2010 to impose a Financial Crisis Responsibility Fee based on certain liabilities of covered institutions, to date very few details have been released regarding the proposal, and no bill has been introduced to Congress. Although the situation could change, the lack of any current or planned consideration by Congress makes enactment in the near future unlikely.

Scope

The fee would only apply to firms with consolidated assets in excess of \$50 billion.

While not entirely clear what would be a 'covered institution', comments from the Treasury Secretary indicate the fee would apply to "US-based bank holding companies, thrift holding companies, certain broker dealers...[and] companies that control insured depositories and certain broker dealers". It was also indicated that US subsidiaries of international firms that fall into these categories, and that have consolidated assets in excess of \$50 billion, would also be covered institutions.

Although details remain unclear, it is generally understood that US branches of foreign banks would not be subject to the fee. US subsidiaries would be covered, however, and only the US balance sheet of the international firm would be considered for purposes of applying the \$50 billion consolidated asset threshold.

Base

Whereas initially the fee would only have been applied to certain liabilities, recent comments have suggested institutions would pay based on their assets adjusted for risk, capital, insured deposits and certain insurance policy reserves.

Rates

While a rate has not formally been proposed, an annual rate of 0.15% has been used for discussion and budgetary purposes.

Effective date

As originally announced, the proposal would have been effective as of 1 July 2010; however the lack of draft legislation makes it unlikely that any fee would take effect before 2011.

Proposals: Hungary

On 22 July 2010 the Hungarian Parliament passed a Bill introducing a special bank tax. This tax will be applicable to a wide range of financial institutions including banks, insurance companies, investment fund

managers, stock exchanges and other specified financial enterprises.

Base

For banks and other credit institutions, the base on which the tax would apply starts with the balance sheet assets, which is then adjusted for domestic inter-bank lending, debt instruments (including certain loans) and shares issued by specified domestic institutions.

Rate

The tax rate will be 0.15%, applied to the first HUF50 billion of the tax base, and 0.50% will then be applied on the amount exceeding HUF50 billion. Different rates and structures apply to other types of institutions covered by the Bill (e.g. investment fund managers will be taxed at 0.028% of the value of funds under management).

Effective date

The tax will apply to financial institutions that closed the books before 1 July 2010.

Other key considerations

- The Bill only specifies the tax liability in detail for 2010, but prescribes significant additional taxes in 2011 and 2012.

Proposals: Other

Several other countries around the world have either adopted, or are considering the adoption of, alternative forms of bank levies. Please contact your local PwC teams for further information.

PwC comments

Several consistent themes are contained in these proposals that are worth highlighting:

- Uncertainty around the scope of institutions covered will need to be addressed. Under current drafting's many organisations not originally intended to be included could actually be drawn in, depending on how the rules are interpreted and ultimately applied.
- Cooperation with regulatory authorities will be essential to ensure the intentions

of the levies are achieved complimentary to proposed regulatory measures.

- Relative competitiveness is likely to be a factor in the long-term effectiveness of the proposals. Pressure to retain financial market activity, and all the related benefits, are likely to come under challenge from emerging financial centres. With respect to the EU in particular, questions around illegal state aid or discrimination may need to be addressed at some point, as the industry may take up a challenge to the legality of the various proposals.
- Issues around the specifics of the calculation will likely persist for some time as definitions are developed. Inconsistencies around accounting standards need to be addressed, and the appropriateness of netting should further be explored.
- As many of these proposals are still in the development stage, or otherwise working their way through the relevant legislative process, opportunities to influence the outcome will continue to be available. Whereas the idea may now have broad acceptance, such that it is no longer necessarily a matter of if there will be bank levies, how each levy will apply and be administered is still up for debate in many jurisdictions.
- While the joint statement issued by Germany, France and the UK is encouraging with regard to international cooperation, differences will likely persist. The most obvious example being the overlap of levies, and the ability to obtain relief where instances of double taxation exist. Without a clearly coordinated effort, it may be some time before such issues are addressed.
- Double tax relief, or the lack thereof, remains a significant concern for multinational financial institutions assessing the potential impact of the various proposals. Where some countries have expressly indicated their bank levy will be outside the scope of their network of existing tax treaties, others have attempted to address the issue by limiting the scope to exclude branches of certain foreign entities and/or devising a credit system to apply when multiple taxes are assessed on the same base. The resulting financial burden could be significant, with the potential need for additional resources to comply with the various proposals.

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