The curious case of bank tax since the bailout

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In a decade when the public made a massive contribution to ensure the banks survived, the amount these institutions have paid in corporation tax are of special interest. In this article, ***Geoff and J. Gay Meeks*** *find a significant decline in receipts following the bailout, which presents some questions as well as answers.*

In the year of the main banking bailout, the UK's public sector net debt rose from 43 per cent to 153 per cent of GDP, according to one measure reported by the Institute of Fiscal Studies. This level was last seen in the aftermath of the Second World War. (Without the financial interventions, the recorded increase was just 7 percentage points.) If no new income for the public purse is generated by a bailout – e.g. through profits from newly nationalised banks – then interest on this additional debt adds to the government deficit. Then, if extra tax revenues or reduced government spending don't compensate for the extra interest payments, a vicious circle develops whereby each year the debt is increased by the extra interest, and next year's interest on the inflated debt is higher still. A raft of painful expenditure cuts was introduced by government following the bailout, but the public sector deficit has shrunk much more slowly than the Chancellor intended; and so the debt has continued to rise.

Partly, it is suggested by Keynesian economists, this is because some of the expenditure cuts are largely self-defeating (think, for example, of firing a nurse only to lose his income tax payments and pay him unemployment benefit). But some tax revenues seem to have been peculiarly sluggish.

In a paper in *Fiscal Studies* (December 2014), we explore for years before and after the banking bailout one source of tax revenues: UK Corporation Tax paid by the banking sector. In accounting terms, Corporation Tax on profits can be seen as a firm's contribution towards social overhead costs met by government – e.g. defence, internal security, public health (think of trying to operate a major business in the absence of such overhead activities – say in Aleppo). In the case of banks, there is an extra layer of social overhead costs not incurred for conventional businesses – implicit insurance against illiquidity (lender of last resort facilities) and insolvency (bailout safety net). So, in a decade when the public made a massive contribution to ensure the banks survived, the banks' contributions to social overhead costs through Corporation Tax are of special interest.

HMRC data show that Corporation Tax receipts from the banks in current prices have declined from £7.0 billion in 2005-6 to just £1.3 billion in 2011-12, £2.3 billion in 2012-13 and £1.6 billion in 2013-14. As a materiality check, this decline in annual receipts from the banks (about £5 billion) is roughly equivalent to total annual expenditure on unemployment benefits.

We studied the financial accounts of the six dominant UK-headquartered banks to see what explanations could be gleaned. This was challenging: transparency on tax matters has not been their strong point. But some answers emerged, as well as some questions.

First, although the Chancellor has reduced the Corporation Tax rate over this period, simulations show that, because of offsetting factors, this contributes little to the explanation of the fall in receipts.

Second, surprisingly, the fall is not because of a collapse in these banks' global operating profits, which were actually marginally higher in the three years 2010-12, after the bailout, than in 2005-7, in the boom before the crisis.

Third, part of the explanation lies in the allowance made for banks to reduce their tax bill by setting against tax the losses on loans which have been "impaired" – where the banks don't expect to recover them in full. The impairments of the six banks rose from £38bn in 2005-07 to £89 billion in 2010-12.

Fourth, the total corporation tax these banks paid globally is actually no smaller in those three years after the crisis than in the three years before; but the UK's share of the total tax has fallen from 30 per cent to 11 per cent. This is not because these banks now rely for much more of their business on overseas subsidiaries: the UK's share of the global assets held by the banks appears to have been relatively stable. (We say "appears" because this is an area where disclosures have been especially limited.)

During the period of our study, the government has exempted some components of overseas income from UK taxation. This has created new opportunities for tax avoidance. In any case, HMRC had described the UK regime as 'relatively generous', compared with other jurisdictions, in the treatment of some deductions for tax purposes. The patterns we observe are consistent with increased and significant corporation tax avoidance. But sufficient data are not disclosed in the accounts for us to quantify this.

As against this, in 2011 the government introduced a new tax on banks, the Bank Levy; and this has raised around £2 billion a year, plugging part of the £5 billion gap in Corporation Tax receipts. The Levy is based not on profits but on the scale of activities reflected in the balance sheet. It has the advantage – from the Exchequer's point of view – that it is levied on the world-wide balance sheet of a bank headquartered in the UK; so, compared with profits, it cannot so readily be manipulated by cross-border tax avoidance transactions. But as HSBC have loudly complained, it falls disproportionately heavily on banks whose principal assets are located overseas, so they trade at a disadvantage compared with banks with fewer overseas assets or banks headquartered overseas. On the other hand, in the absence of such a levy, with just a corporation tax on profits, a domestic bank is at a disadvantage, having fewer opportunities to structure its activities via offshore businesses so as to avoid UK Corporation Tax on profit (echoing the complaints from domestic competitors of Amazon and Starbucks).

The Chancellor's July 2015 Budget scales down the Bank Levy, but aims to restore some tax revenue by raising the Corporation Tax rate payable by banks over the newly lowered basic rate. This was seen as a response to the threat from HSBC to move their HQ offshore. However, as we have argued, the yield from Corporation Tax is less reliable than that for the Levy, because of the opportunities for tax avoidance when the tax base can be manipulated by transferring profits overseas.

How to plug the tax gap is, then, linked to the challenge of constructing a tax base which is both robust and offers a level playing field for domestic and multinational companies. This relates to efforts to discourage 'beggar my neighbour' races to the bottom by countries competing with tax concessions to attract multinationals. This in turn is linked to attempts to secure less stingy contributions to the cost of social overheads from firms operating in poor countries.

But, on all these public policy issues, debate is seriously hampered by opaque, incomplete and inconsistent disclosures by firms of their tax affairs.

About the Authors

Geoff and J. Gay Meeks work at the University of Cambridge – the former as Professor of Financial Accounting at Cambridge Judge Business School, the latter as Senior Research Associate at the Centre for Development Studies