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By Antony Seely

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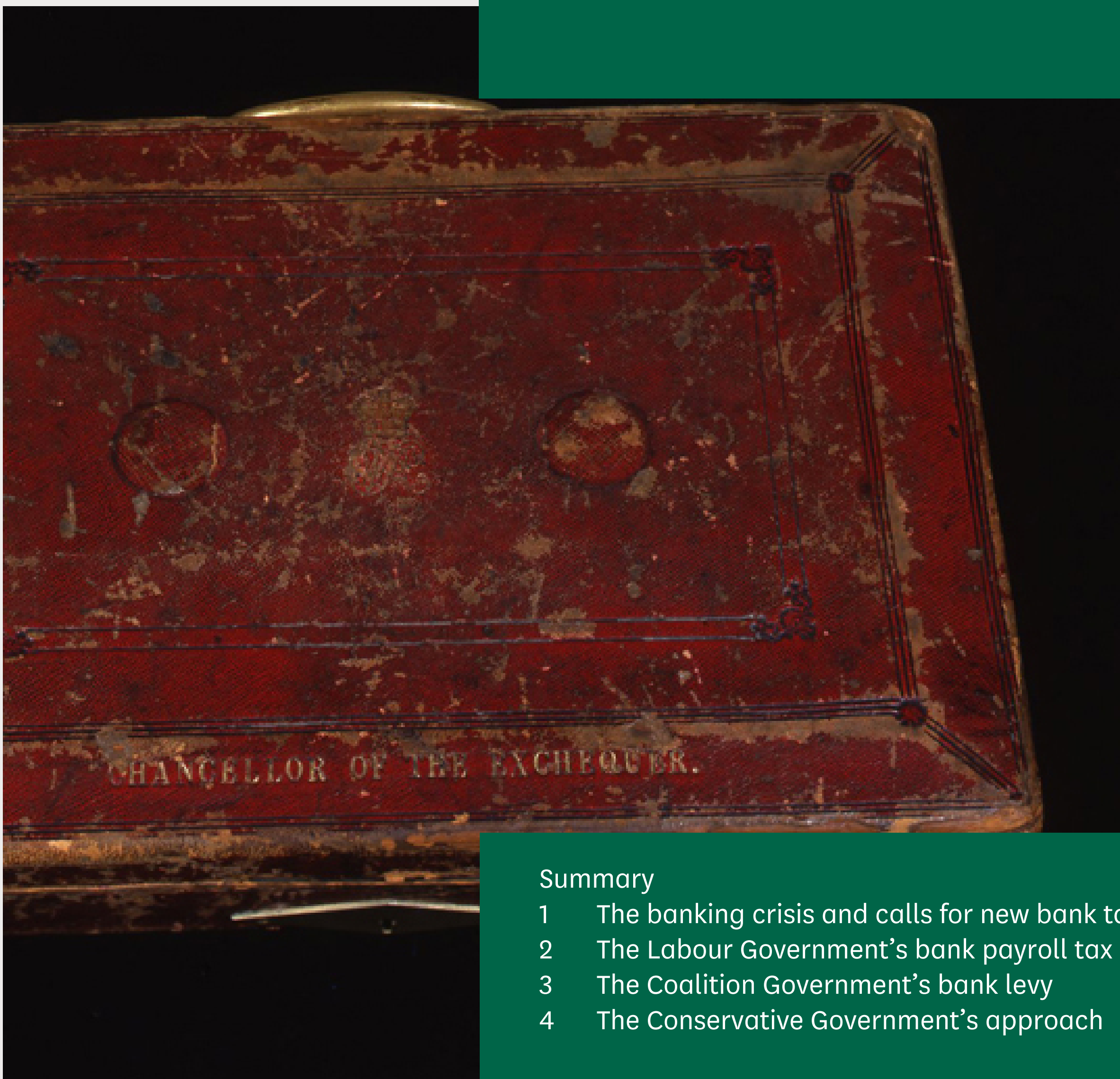
Taxation of banking



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Summary

This Commons Library briefing looks at the public debate over the tax treatment of the banking sector in the wake of the 2008 financial crisis, before discussing the different approaches taken in successive years by Labour, Coalition and Conservative Governments.

The bank payroll tax (2009-10)

In December 2009 the then Chancellor, Alistair Darling, announced a new bank payroll tax: "a special one-off levy of 50% on any individual discretionary bonus above £25,000" to "be paid by the bank, not the bank employee." Mr Darling anticipated that the levy would apply from the date of his statement to the end of the tax year – 5 April 2010 – and raise "just over £500m".[1] In the March 2010 Budget the Labour Government confirmed that the payroll tax would not be extended, though its yield proved far higher than initially forecast: £3.4 billion.[2]

The bank levy (2010-15)

The Coalition Government set out its priorities for taxation in its agreement, published in May 2010, and as part of this stated that it would "introduce a banking levy and seek a detailed agreement on implementation."[3] **In his first Budget statement on 22 June 2010 the then Chancellor George Osborne announced that a new levy would be introduced from January 2011 to "apply to the balance sheets of UK banks and building societies, and to the UK operations of banks from abroad" which would "generate over £2 billion of annual revenues."[4]** A consultation paper was published in July, followed by draft legislation in December 2010. Provision to introduce the levy was included in the Finance Act 2011 (specifically, s73 & Schedule 19).

Over the 2010-15 Parliament the Coalition Government amended the rates of the levy several times, with a view to maintaining the yield that it had initially anticipated.

First, in February 2011 Mr Osborne confirmed that the rate of the levy would be higher than initially proposed in its first year of operation,[5] and in the 2011 Budget the Chancellor announced a further change in rates to offset a 1% cut in the main rate of corporation tax for 2011/12, additional to the reductions in

1 HC Deb 9 December 2009 c367

2 HM Revenue & Customs (HMRC), PAYE and CT receipts from the banking sector, (2021 edition), September 2021 (Table 1)

3 HM Government, The Coalition: our programme for government, May 2010 p9

4 HC Deb 22 June 2010 c176

5 HC Deb 8 February 2011 cc310-327

corporation tax announced in his first Budget. In his Autumn Statement on 29 November 2011 Mr Osborne announced a third change in the levy rates from January 2012 to offset an expected shortfall tax receipts.[6] In his 2012 Budget Mr Osborne announced that the main rate of corporation tax would be cut by an additional 1%, and that the rates of the bank levy would be increased from 1 January 2013, to take account of the benefit that the banking sector would enjoy from this tax cut.[7] In his Autumn Statement on 5 December 2012 Mr Osborne another 1% reduction in the main rate of corporation tax from April 2014, to 21%. As before, the rates of the bank levy would be increased to prevent the banking sector from benefiting from the tax cut.[8] In his 2013 Budget the Chancellor stated that from April 2015 the main rate of corporation tax would be set at 20%; the rate in the levy would be increased from 1 January 2014 accordingly.[9]

In his Autumn Statement on 5 December 2013 Mr Osborne announced that the rate for 2014 would be increased, and the base of the tax broadened, following a review of the tax over the previous summer.[10] Taken together these changes were forecast to raise £265m in 2014/15, rising to £520m in 2015/16.[11] These changes were confirmed in the 2014 Budget. At the same time the Coalition Government launched a consultation on the merits of a new charging mechanism, in which the headline rate would be replaced by a new banding approach for determining a bank's charge. It was anticipated that any changes to the design of the levy – which would be revenue-neutral – would be made by introducing provisions to the *Finance Bill 2014* at its report stage.[12] Responses to the consultation indicated that this reform would "create uncertainty over banks' charges, strengthen the incentives for activities to be relocated overseas and create arbitrary differences between banks' effective tax rates and the relevance of the levy's behavioural incentives", and no changes to the tax were made at this time.[13]

Finally in the Government's last Budget before the 2015 General Election, the Chancellor announced an increase in the rates of the levy, on the grounds that, "as our banking sector becomes more profitable again … it can make a bigger contribution to the repair of our public finances."[14] The new rates would apply from 1 April 2015, and it was estimated that this would raise around £900m a year from 2016/17.[15]

6 HC Deb 29 November 2011 c805
7 HC Deb 21 March 2012 c803
8 HC Deb 5 December 2012 c881. This was forecast to raise £545m per year from 2014/15 (Autumn Statement, Cm 8480, December 2012 para 2.79, Table 2.1 – item 34).
9 HC Deb 20 March 2013 c940. The increase in the levy rate was forecast to raise around £250m from 2015/16 (Budget 2013, HC 1033, March 2013 p65, Table 2.1 – item 40).
10 HC Deb 5 December 2013 c1107
11 Autumn Statement, Cm 8747, December 2013 p78 (Table 2.1 – item 20)
12 Budget 2014, HC 1104, March 2014 paras 2.122-5
13 HC Deb 26 June 2014 cc22-3WS
14 HC Deb 18 March 2015 c773
15 HM Treasury, Budget 2015 Policy Costings, March 2015 p25

The new bank surcharge (2015-20)

The then Chancellor George Osborne announced two reforms to bank taxation in the Conservative Government's first Budget in July 2015:

- **a gradual reduction in the rate of the bank levy over the period 2016-21, and,**
- **the introduction of a supplementary 8% surcharge on banking sector profit to apply from 1 January 2016.**

The new bank surchrage would not apply to the first £25m of profit within a group.[16] The Chancellor also confirmed that the tax base of the bank levy would be amended, with effect from January 2021, so that UK headquartered banks would be levied only on their UK balance sheet liabilities.[17]

At the time it was estimated that the bank surcharge would raise more than the cost of reductions in the bank levy rate, so that taken together these measures would raise around £1.7bn in total over the five years 2016/17 to 2020/21.[18] In addition corporation tax receipts from the banking sector were projected to rise, from the imposition from 2015/16 of a 50% limit on the losses banks could carry forward to set against taxable profits in future years.[19]

Over the first five years of its operation, annual receipts from the bank levy rose from £1.6bn in 2011/12 to £3.4bn in 2015/16. Receipts have declined consistently since then, to £2.3bn in 2020/21. Since its introduction annual receipts from the bank surcharge rose from £1.1bn in 2016/17 to £2.0bn in 2019/20, before falling to £1.4bn in 2020/21.[20]

Review of the bank surcharge (2021-)

In the Spring 2021 Budget on 3 March the Chancellor, Rishi Sunak, announced an increase in the rate of corporation tax from 19% to 25% from April 2023, as part of a series of reforms to corporate taxation.[21] The Budget report noted that "without any other action, due to the additional bank surcharge of 8%, the increase in the main corporation tax rate to 25% would make UK taxation of banks uncompetitive and damage one of the UK's key exports." The Government would review the surcharge and set out in the autumn how it would "ensure that the combined rate of tax on banks' profits does not increase substantially from its current level, that rates of taxation here are competitive with the UK's major competitors in the US and the EU,

16 HC Deb 8 July 2015 c326. Summer Budget 2015, HC264, July 2015 para 2.126-7
17 For details see, HMRC, Bank levy: rate reduction and, Bank Corporation Tax Surcharge, 8 July 2015
18 Summer Budget 2015, HC264, July 2015 p73 (Table 2.1 – item 17). See also, OBR, Economic and fiscal outlook supplementary fiscal tables, July 2015 (see table 2.40)
19 It was estimated the total Exchequer yield over the five years 2015/16 to 2019/20 would be around £4bn: Budget 2015, HC 1093, March 2015 p66 (Table 2.2 – item t).
20 HMRC, Tax receipts and National Insurance contributions for the UK, October 2021
21 HC Deb 3 March 2021 cc256-8

and that the UK tax system is supportive of competition in the UK banking sector."[22]

On 27 October the Chancellor presented the Autumn Budget and Spending Review, and in his statement announced the bank surcharge would be set at 3%, so that "the overall rate for corporation tax on banks will, in 2023, increase from 27% to 28%." In addition the annual allowance would be increased from £25m to £100 million.[23] It is estimated that the cost of cutting the rate of the surcharge will be £830m in 2023/24, rising to £1.02bn by 2026/27. HMRC's impact assessment notes that "these costings account for the impact of amending the surcharge only, and thus exclude the revenue raised from the increase in Corporation Tax announced and set out at Spring Budget 2021. Overall, banks will pay more tax as a result of changes announced this year."[24]

In its most recent Economic and Fiscal Outlook published alongside the Budget, the Office for Budget Responsibility projected that receipts from the bank surcharge will fall from £1.6bn in 2021/22 to £500m a year from 2024/25. Receipts from the bank levy are forecast to remain around £1.3-£1.2m a year from 2021/22.[25]

Statistics on bank taxation and the financial sector

HMRC publish statistics on tax receipts from the banking sector as a whole – that is, PAYE, corporation tax, bank levy and CTS. Since 2011/12 receipts have risen from £20.5bn in 2011/12 peaking at £30.6bn in 2018/19. Over the last three years receipts have droppd to £28.8bn in 2020/21.[26]

Of related interest to this Library briefing, key statistics on output, jobs, and trade in UK financial services are presented in Financial services: contribution to the UK economy, Commons Library briefing CBP6193, 8 December 2021.

22 Budget 2021, HC 1226, March 2021 para 2.82
23 HC Deb 27 October 2021 c283; Autumn Budget and Spending Review 2021, HC 822, October 2021 paras 2.78-80, para 5.67
24 HMRC, Amendments to the surcharge on banking companies, 27 October 2021
25 OBR, Economic and Fiscal Outlook, CP545, October 2021 p99, Table 3.4
26 HMRC, PAYE and CT receipts from the banking sector, (2021 edition), September 2021 (Table 1)

1 The banking crisis and calls for new bank taxes

Following the end of the financial crisis the case for a windfall tax on the banking sector was widely debated, as some major banks returned to profitability, and it seemed likely that a good number of those working in the City would receive considerable end-of-year bonuses. As was often pointed out, the fact that the banking system survived the financial crisis of 2007/08 derived in no small part to the support it received from the taxpayer, and yet some of those who benefited most from this return to profitability had made no extra contribution for this state of affairs.[27] In a consultation paper in March 2009, the Financial Services Authority noted, "Higher profits translate into higher bonuses for the employee, whereas bonus payments cannot be lower than zero. Therefore, losses are borne by long-term shareholders and society, but only to a small extent by employees and short-term shareholders."[28]

In addition some commentators argued that one of the causes of the financial crisis had been the way bankers were paid to take inordinate risks. In May 2009 the Treasury Committee argued that, "whilst the causes of the present financial crisis are numerous and diverse, it is clear that bonus-driven remuneration structures prevalent in the City of London as well as in other financial centres, especially in investment banking, led to reckless and excessive risk-taking. In too many cases the design of bonus schemes in the banking sector were flawed and not aligned with the interests of shareholders and the long-term sustainability of the banks."[29]

In an interview in August 2009, Adair Turner, then chairman of the Financial Services Authority, said that new taxes might be necessary to curb excessive profits and pay in the financial sector.[30] In a speech eighteen months later Lord Tuner made the case that the profitability of the banking sector had been based on its ability to extract economic rent, and thereby increase social inequality, rather than generating economic growth – and that

27 For more details see, Bank rescues of 2007-08: outcomes and cost, Commons Library briefing, 8 October 2018.

28 FSA, *Reforming remuneration practices in financial services*, Consultation Paper 09/10, 18 March 2009, p21

29 *Ninth report: Banking Crisis: reforming corporate governance and pay in the City*, 15 May 2009 HC 519 2008-09 para 25. See also, *Banking executives' remuneration in the UK*, Commons Briefing paper CBP6204, 9 June 2017.

30 "FSA chief backs City curbs with global tax", *Financial Times*, 27 August 2009

taxation would be an appropriate response to these supernormal returns.[31] Following Lord Tuner's interview, a correspondent to the *Financial Times* suggested that imposing a tax charge on banks based on the bonus payments they made to staff would "give banks a choice: they can cut out the bonuses and avoid the tax or carry on as before, in which case the taxpayer would also get a bonus, which seems only fair as it was taxpayers' money that was spent to keep to the banks in business."[32] Some weeks later, the paper's columnist Martin Wolf argued that a one-off tax on bonuses was appealing, even though "no sensible person" would normally support windfall taxes, being "a sop to prejudice, a burden on risk-taking and a form of arbitrary confiscation" but that this time "it really does look different." Mr Wolf noted that financial institutions had been the beneficiaries of unlimited state insurance, that was the primary reason for their current profits even though the rationale for this had been to restore the financial system. Bankers had enjoyed huge rewards even while they bore substantial responsibility for the crisis. Morever, exceptional interventions to recoup costs after the crisis were the obvious cororally to exception inteventions to sustain the financial syste in the midst of that crisis. Mr Wolf went on to propose a a one off windfall tax on bonuses : "There is no public interest in such payments. Since it would be a one-off event, it should not affect incentives … If the tax applied to all banks operating within a given jurisdiction, it would not affect competitiveness among them … The time has come for some carefully judged populism."[33]

In a speech to the Conservative Party conference on 6 October, the then Shadow Chancellor, George Osborne, said an incoming Conservative administration might introduce a new levy on banking, saying, "if we find the [financial support from the taxpayer] that should be going into stronger bank balance sheets is being unreasonably diverted into bigger pay and bonuses - we reserve the right to take further action and that includes using the tax system."[34] In the next few days there was considerable speculation that the Treasury was actively planning a windfall tax on bonuses,[35] although – as the *Times* pointed out in an editorial – there were strong arguments against singling out one sector of the economy for a one-off tax, since "there is no inherent reason for refraining from the exercise in other cases" going on to suggest that the most direct way to repay taxpayers would be "to that is to ensure that the banks are swiftly restored to health, so that the taxpayer's stake can be sold at a profit."[36]

31 The speech composed the 2011 Clare Distinguished Lecture in Economics and Public Policy, and was discussed by Robert Peston, then business editor at the BBC: "Turner's radical changes at the banks", *BBC News*, 1 March 2011.

32 "Letters: Why not start with a tax on bonuses?", *Financial Times*, 1 September 2009

33 "Tax the windfall banking bonuses Why windfall taxes are appealing", *Financial Times*, 20 November 2009

34 Conservative Party press notices, *Speech by George Osborne: We will lead the economy out of crisis*, 6 October 2009. The party's manifesto for the 2010 General Election confirmed their plans for a levy on banks (Conservative Party, *The Conservative Manifesto*, April 2010 p29).

35 For example, "Banks may face windfall tax over bonuses", *Guardian*, 18 October 2009 & "The options: five ways to tax those high-earning bankers", *Guardian*, 21 October 2009

36 "Leader: Ill windfall", *Times*, 20 October 2009. See also, "A bonus tax could be an impossible dream", *Times*, 7 December 2009

Similarly Angela Knight, chief executive of the British Bankers Association was quoted as saying that windfall taxes were "populist, political and penal", and would encourage banking firms to leave the UK.[37] However, the case for a windfall levy was given a significant boost with the news that the directors of Royal Bank of Scotland – 70% owned by the taxpayer – were planning to resign en masse if the Government opposed proposed bonuses for RBS employees,[38] while other bank executives argued that **any** form of tax charge would undermine the City.[39]

Writing in the *Guardian*, the paper's economics editor, Larry Elliott, suggested a "windfall tax is justifiable on three key grounds: the profits made by the City this year have been exceptional due to the actions of the government; incandescent public anger that makes action against bankers as necessary as was action on MPs' expenses, and the need for ministers to win a showdown with the bankers on who is actually running the country. The City has been behaving with supreme and breath-taking arrogance in the past three weeks, apparently convinced the government worm will not turn. Now it has."[40] An editorial in the *Financial Times* was also supportive:

> Well-run countries limit the prices monopolies (such as utilities) may charge, in effect transferring profit to consumers. Characteristic of such sectors is economic "rent" that springs from legally-sanctioned market power … As for financial markets, surely no thinking observer can now call them free and well-functioning … [The current level of banks' profits] serve the public interest only if they pad capital cushions, not bankers' wallets … If by satisfying voters' demand for fairness [a one-off bonus tax] … boosted support for reforms of our broken financial system, it could be a laudable move.[41]

37 "Bankers criticise windfall tax plan", *BBC News online*, 7 December 2009; "Bankers warn of exodus over windfall tax", *Financial Times*, 8 December 2009

38 "RBS board to quit if chancellor vetoes £1.5bn in bonuses", *BBC News,* 2 December 2009

39 "Barclays' Bob Diamond defends bonuses", *Guardian*, 8 December 2009

40 "The case for a windfall tax on bank bonuses is unanswerable", *Guardian*, 7 December 2009

41 "Editorial : The bonus points in Darling's plans", *Financial Times*, 8 December 2009

2 The Labour Government's bank payroll tax

2.1 Pre-Budget Report 2009

In his Pre-Budget statement on 9 December 2009 the then Chancellor, Alistair Darling, announced a new one-off bank tax to be levied on any bonus payment of over £25,000. Mr Darling argued that a windfall tax on profits would be counterproductive, but that taxing bonuses was justified, as the ability of any banks to make bonuses of this size at this time relied very much on the support taxpayers had given the entire financial sector:

> Last year, the banks made collective losses of £80 billion in this country alone. This would have been much higher without the unprecedented level of support from the taxpayer. There is no bank that has not benefited, either directly or indirectly, from this help. This should be a time for banks to rebuild their capital base and become stronger. A tax on profits, as has been suggested, would prevent them from doing that, so I have decided against a windfall tax.
>
> However, there are some banks who still believe their priority is to pay substantial bonuses to some already high-paid staff. Their priority should be to rebuild their financial strength and increase their lending, so I am giving them a choice: they can use their profits to build up their capital base, but if they insist on paying substantial rewards, I am determined to claw money back for the taxpayer.
>
> I have decided to introduce from today a special one-off levy of 50 per cent. on any individual discretionary bonus above £25,000. This will be paid by the bank, not the bank employee, and anti-avoidance measures will be introduced with immediate effect. High-paid bank staff will, of course, also have to pay, as usual, income tax at their top rate on any bonus they receive. On a cautious assumption, which includes our expectation that some banks will rein back on bonuses, this levy is expected to yield just over £500 million. That additional money will be used to pay for the extra measures that I have already announced, such as help for the young and older unemployed to get back into work.[42]

As noted, at this time the new payroll tax was forecast to raise £550 million in total. By comparison, Mr Darling announced another tax increase at this time: a 0.5 percentage point rise in the rates of National Insurance contributions (NICs) on employees, employers and the self-employed from April 2011. Taken with an increase in the employees threshold for paying NICs, to mitigate the impact of this increase on lower earners, this change was

[42] HC Deb 9 December 2009 c367

forecast to raise just over £3 billion a year.[43] This was in addition to a 0.5% rate rise announced the year before. The combined 1% rise in NI rates took effect from April 2011, though the Coalition Government increased the NI threshold for employers to mitigate the impact on employment.[44]

The *Pre-Budget Report* explained that the levy would apply to bonuses paid between 9 December 2009 and 5 April 2010:

> The Government today announces that where bank (and building society) employees are awarded discretionary bonuses, in whatever form, above £25,000 in the period from the Pre-Budget Report to 5 April 2010, the banks paying these bonuses will pay an additional bank payroll tax of 50 per cent on the excess bonus over £25,000. The tax will not be deductible in computing the taxable profits of affected companies.
>
> This tax will encourage banks to consider their capital position and to make appropriate risk adjustments when settling the level of bonus payments above the threshold, which is at the level of median earnings in the UK. If banks choose to make awards that are not consistent with a prudent approach to risk, it is only fair that they contribute more to the public finances, in a year when profits have been facilitated by significant taxpayer support for the banking sector as a whole.
>
> It is intended that in the longer term, remuneration practices will be changed as a result of corporate governance and regulatory reforms, as outlined later in this chapter. The one-off bank payroll tax will apply until 5 April 2010, but the Government will consider extending the period of the charge so that the tax remains in place until the relevant provisions of the Financial Services Bill come into force. Where there is evidence of avoidance schemes being put in place, the Government will take action to close those schemes.[45]

Further details of the new tax published alongside the Pre-Budget Report. Notably the tax would not affect the tax or NICs liabilities of bank employees, and it could not be taken into consideration when calculating a banks' taxable profits.[46] HMRC also issued guidance on the scope of the levy, and, in particular, how these provisions would define 'banking employment', to determine what type of bonuses would be liable:

> A Taxable Company will be charged to the bank payroll tax on the aggregate of the amounts of "Chargeable Relevant Remuneration" awarded to or in respect of its "Relevant Banking Employees" in the chargeable period at the rate of 50%.
>
> Chargeable Relevant Remuneration is the amount by which "Relevant Remuneration" awarded to or in respect of a Relevant Banking Employee exceeds £25,000 …

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43 Cm 7747 December 2009 p74, p173

44 For details see, National Insurance contributions: changes from April 2011, Commons Library briefing Paper CBP5550, 8 November 2013.

45 Cm 7747 December 2009 p44. As noted the Labour Government introduced legislation at this time to reform the regulation of executive remuneration; for details see, Financial Service Bill 2009-10, ommons Library Library briefing RP09-84, 27 November 2009.

46 HM Revenue & Customs Pre-Budget Note PBRN02, 9 December 2009

Relevant Banking Employee

An individual will be a Relevant Banking Employee of a Taxable Company if that individual is employed by the Taxable Company in a "Banking Employment" and either the individual is resident in the United Kingdom in the tax year 2009/10 or performs duties of the Banking Employment at any time in that year wholly or partly in the UK. For this purpose, Banking Employment means an employment which wholly or mainly involves duties that relate either directly or indirectly to activities that are "Relevant Regulated Activities" …

Relevant Regulated Activities

The Financial Services Authority authorises financial institutions to carry out certain types of financial activities called 'regulated activities'. For the purposes of these provisions certain regulated activities are prescribed as "relevant regulated activities".

These are:

- Accepting deposits (in other words providing current accounts and deposit accounts to retail customers);
- Dealing in investment as principal (in other words trading in derivatives, bonds commodities etc. on their own account);
- Dealing in investments as agent (in other words trading in the above types of investments as behalf of clients);
- Arranging deals in investments;
- Safeguarding and administering investments on behalf of clients; and,
- Regulated mortgage contracts (in other words carrying out retail mortgage lending).[47]

Subsequently HMRC issued a statement to underline that the test would be amended, to ensure it did not capture financial companies outside the banking sector.[48]

2.2 Debate on the payroll tax

In his initial response to the Chancellor's statement, the then Shadow Chancellor, George Osborne, gave the new levy a cautious welcome, arguing that "the real test of this new tax will be whether it curbs bank bonuses

47 HMRC, *Bank Payroll Tax : Technical Note, Draft legislation and Explanatory Notes*, 9 December 2009 pp 5-6

48 HMRC, *The bank payroll tax announced at PBR 2009*, December 2009. see also, "Finance firms escape super tax", *Guardian*, 20 December 2009.

instead of curbing bank lending".[49] The Liberal Democrats Treasury spokesman, Vincent Cable, was more circumspect:

> The Chancellor has clearly been provoked into action by the extraordinarily stupid and arrogant behaviour of the RBS board. What he has come up with, to the extent that it is intelligible, is an extraordinarily complex mechanism ... Surely it makes more sense, as I think the Prime Minister entertained when he went to the G20 summit, not to try to tax bankers separately from other high earners, but to have a levy on bank profits because the banks depend on a taxpayer guarantee. Until they can be broken up and can stand on their own two feet, they have to pay for the insurance that the taxpayer provides.[50]

Press reaction to the PBR focused generally on the state of the public finances, though there was some comment on the new tax, often pointing out how limited it would be in revenue terms. Writing in the *Times*, Anatole Kaletsky called the tax "a financial nonsense" which "will prove unsustainable beyond the next election and will be ridiculed by governments and regulators in other countries."[51] In the *Guardian*, Larry Elliott, suggested that "most of the headlines will be about the one-off 50% levy on City bonuses above £25,000, but there will be real – and permanent – pain for those lower down the income scale" from the increase in NI rates, and the announcement of a 1% cap on public sector pay settlements for 2011-13.[52] The *Financial Times* termed it "an artful scheme" which "could have been worse":

> While this levy is justified, there are two important caveats. First, trying to outsmart banks seeking to escape the tax unfairly should not be the main business of the Treasury's finest minds. More important tasks are setting up a credible resolution regime and planning how to withdraw the state's extraordinary levels of support for the financial system.
>
> Second, this must not be an opening shot in a wider assault on the City. Mr Darling himself sounded cool-headed, but he will need to keep in line his more excitable ministerial colleagues. The UK's decision to act alone rather than as part of a joint action by Group of 20 countries already creates a risk of an exodus from the City. If international financial institutions believe that operating in London will expose them to unpredictable tax rises driven by populism rather than pragmatism, that risk will become severe.[53]

The possibility of bankers leaving the UK was raised by Stuart Adam of the Institute for Fiscal Studies, at the IFS' post-PBR presentation. Mr Adam suggested that by **itself**, it was most unlikely that the tax would change people's decisions as to where they wanted to live and work, but that it might prompt fears of 'more to come', especially if other changes announced before – the new 50% higher income tax rate and the charge on non-domiciled taxpayers – were taken as signalling a "new direction."[54]

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49 HC Deb 9 December 2009 c373

50 HC Deb 9 December 2009 c376

51 "Oh no, Darling: you've failed", *Times*, 10 December 2009

52 "The real pain is yet to come", *Guardian*, 10 December 2009

53 "Editorial: Darling's route to austerity still shrouded in fog", *Financial Times*, 10 December 2009

54 *Tax cuts for business, tax rises for the rich*, IFS Pre-Budget Report 2009, 10 December 2009

The Treasury Select Committee took evidence on the PBR in the week after the Chancellor's statement. During these sessions, Nick Ainger MP asked John Whiting (Tax Policy Director, Chartered Institute of Taxation) and Robert Chote (then director of the IFS) about the potential yield from the tax:

> **Q86 Nick Ainger**: The calculation is that it should raise £550 million, but given what is emerging about the impact, why would anyone want to end up paying that sort of penalty? Surely the idea is to change behaviour and address the real issue, which is the bonus culture and the risk element attached to it.
>
> **Mr Whiting**: I go along with that. I think one of the main messages is, as I say, stop and think to make sure that the management of your whole bonus pattern, if I can term it that, is properly robust, properly geared to achievable objectives, and maybe you take a pause on the bonus payments and come back and start paying them again next summer, in which case the bonus tax may raise very little. On the other hand, I know anecdotally that some banks are already saying they will be going ahead, so it will raise something, but whether it raises the £550 million remains to be seen.
>
> **Mr Chote**: I think a very good question to ask Treasury officials when you have them before you is what do they think the total bonus pool would have been in the absence of this policy and how big do they think it will be as a result of it.
>
> The other point to bear in mind in thinking about how much money this raises is they have got an estimate of how much the bonus tax itself raises directly, but another way you could look at this as an anti-avoidance measure with regard to the introduction of the 50p rate. The Treasury may have had a concern that with the 50p rate some way off, the banks would have brought forward remuneration earlier in order to get it in before then and, therefore, this will have an impact on the amount you get from income tax as well as from the bonus specifically.[55]

When the Chancellor appeared before the Committee, he emphasized how the main purpose of the levy was to encourage a change in behaviour, rather than revenue yield:

> I want to ensure that we do look after and garner the reputation of the City of London and the UK financial services industry which, properly supervised and regulated, has a very good future in front of it, but I say to the bankers you have got to help yourselves get through this process. That means if you want yourselves off the front pages, for goodness sake, show the sort of restraint that the general public would want you to. The reason we have introduced this measure - and it is not a great revenue raiser; it does not bring in that much - is to send a clear signal that we need to change behaviour.[56]

At a later stage of the session, Mr Brady raised the point mentioned by Robert Chote – the Treasury's estimate of what the banks' bonus pool would have been, without the new tax:

> **Q364 Mr Brady**: What was your estimate of how much would have been paid in bonuses before April if you had not introduced this tax?

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55 Treasury Committee, *Fourth report*, HC 180 of 2009-10, 6 January 2010 Ev12-13

56 *op.cit.* Q243 Ev32

> **Mr Darling**: We made an estimate, and it is only an estimate because most banks have not yet decided, that the pool would be about £3 billion for banks.
>
> **Q365 Mr Brady**: If that had been the case, is it not also true to say that the Treasury would have raised more money from taxing at 50% plus National Insurance contributions than it will from the new tax you have put in place?
>
> **Mr Darling**: Again, caution being the watchword, we made an assumption that a number of banks would either pay less or in some cases no bonuses and that was why we did not put in a higher figure. We assumed there would be some behavioural change. I say now that until we actually know what happens in the first quarter of next year, that being the bonus season, we will not know. The sum that is in the book and which I think I referred to in my speech was £550 million. That is what is down as what we expect the tax take to be.
>
> **Q366 Mr Brady**: If the bonuses are being paid at the rate of £2.5 billion or £3 billion, some estimates have been made that the receipts in tax would have been £200 million to £300 million more than you are going to get.
>
> **Mr Darling**: Inevitably, when you have got a tax like this, which is a one-off, not something that is going to continue, and where firms can decide they are not going to pay a bonus for whatever reason, tax or not, therefore no tax is payable, and the only ones who will pay tax are the ones who insist on paying their bonuses, unlike something like income tax, National Insurance or whatever else there is bound to be some degree of variance as to what you actually get in at the end of the day.
>
> I just want to stress that what I am trying to do here, and I know that in some banking quarters this is novel and contentious, is to try and change the culture, the behaviour. I think most people in this country simply take the view that it is not inevitable, it is as sure as night follows day, that you have got to pay some of these people extremely high salaries and I thought the shareholders of some of these institutions might take an interest in this as well.[57]

The Committee did not make any specific recommendations about the new tax, but suggested that its behavioural impact should be evaluated after the end of the tax year:

> The Treasury has estimated that the new bank payroll tax will raise approximately £550m. Mr Mark Bowman, Director, Budget and Tax, HM Treasury, explained that this was a net figure which took into account the reduction in income tax and NIC receipts received by the Treasury in response to the anticipated lower payment of bonuses. We sought clarification from the Chancellor and Treasury officials as to whether revenue raised by the Treasury might have been greater if the tax had not been introduced and the Government received income tax and NIC receipts from a larger bonus pool. In response, the Chancellor reiterated that the key objective of the policy measure was to encourage bonuses not to be paid or paid at lesser rates.
>
> There has been some confusion about how many people will be affected by the tax and exactly to whom the tax will apply. Treasury officials sought to clarify the situation, with Edward Troup explaining that the Treasury believed that the tax "would apply to somewhere between 20,000 and 30,000 individuals" and

57 *Fourth report*, HC 180 of 2009-10, 6 January 2010 Ev47-48

> that the policy would apply to "banks and banking groups and financial trading companies within banking groups". He argued that most people would "have a good sense of whether that [the tax] applies to them or not", but acknowledged that banking was "a complex industry" and that therefore it was inevitable that there would be some cases at the margin where clarification and guidance would need to be sought.
>
> The Government considers that the purpose of the tax on bank bonuses is to change behaviour so that banks increase their capital, rather than providing large discretionary payments to employees. We urge the Treasury Committee in the next Parliament to assess how effective it has been in this, and to examine the effectiveness of any regime introduced by the Financial Services Bill, in terms both of its success in altering bank behaviour, and of its effect on the competitiveness of the UK financial sector.[58]

In September 2010 Mr Darling gave a speech at a financial services conference at which he suggested that the payroll tax had failed to change bankers' behaviour, but it was highly unlikely that it would be reintroduced. The *Financial Times* quoted Mr Darling as saying, "I think it will be a one-off thing because, frankly, the very people you are after here are very good at getting out of these things and … will find all sorts of imaginative ways of avoiding it in the future."[59]

Some days later the paper reported that there had been little evidence that the tax had resulted in any 'exodus' of bankers and traders leaving the UK: "from practical concerns over infrastructure and regulation to quality of life issues, executives are proving 'stickier' than many feared."[60] In his memoirs published in 2011 Mr Darling recollected that "the right wing press … was courting lurid stories of bankers planning to flee the country and decamp to Switzerland. I did not believe it. As one banker said: 'Have you been to Geneva?' And he was Swiss."[61]

2.3 Yield from the payroll tax

In the March 2010 Budget the Labour Government confirmed that the tax was a 'one-off', and that there was "evidence that bonuses have been reduced somewhat because of this tax."[62] At this time the Treasury estimated that the tax would raise £2 billion in total, though income tax and NICs receipts in 2009/10 would be reduced by £0.7 billion. To capture this impact, the figure for the tax's yield given in the summary of Budget measures was put at £1.3 billion in 2010/11:

> The net yield of £1.3 billion compares to the expected net yield of £550 million at the 2009 Pre-Budget Report. The updated yield is based on a higher forecast for banks bonuses including deferred awards in 2009-10 which are

58 *Fourth report*, HC 180 of 2009-10, 6 January 2010 p41
59 "Supertax on bankers failed, says Darling", *Financial Times*, 2 September 2010
60 "Banker exodus fails to hit City", *Financial Times*, 16/17 September 2010
61 Alistair Darling, *Back from the brink: 1,000 days at Number 11*, 2011 pp272-3
62 *Budget 2010*, HC 451 March 2010 para 3.24

> now expected to rise by around 25 per cent on 2008-09 levels, while the Pre-Budget Report forecast a fall. Receipts from the bank payroll tax are estimated to be £2 billion but the behavioural change from introduction of the tax is expected to reduce income tax and NICs receipts relative to not introducing the tax, which reduces the net yield of the policy to £1.3 billion. Due to National Accounts rules bank payroll tax receipts are scored in 2010-11 and the behavioural impact on income tax and NICs impacts on 2009-10 receipts.[63]

Legislation to introduce the tax was included in the *Finance Act 2010*. This was one of the pieces of legislation agreed with cross-party support in the 'wash up' period before the Dissolution of the House, and the 2010 General Election – so these provisions were not debated.

As it transpired, the yield from the tax was a good deal higher than initially anticipated – at £3.5 billion in gross terms.[64] Further details on the yield of the tax were given in answer to PQs:

> **Lord Myners**: To ask Her Majesty's Government what adjustments HM Treasury made to the gross contribution to calculate the net tax estimated to have been received under the bank payroll tax. [HL3074]
>
> **Lord Sassoon**: HM Revenue and Customs collected £3.45 billion of gross receipts from the bank payroll tax. It is estimated that the net yield was £2.3 billion. In line with the general methodology set out in the June 2010 Budget policy costings document, the net yield takes account of all direct behavioural effects of a measure on the tax base itself (in this case the tax base for the bank payroll tax) or closely associated receipts (in this case receipts from income tax and national insurance contributions).[65]
>
> *
>
> **Lord Myners**: To ask Her Majesty's Government, further to the Written Answer by Lord Sassoon on 8 November (WA 6), whether the assumptions made included an amount by which bank bonuses would have been higher in the absence of the Bank Payroll Tax; and, if so, what was the amount so assumed.[HL3858]
>
> **Lord Sassoon**: The gross and net yields from the bank payroll tax (BPT) were quoted in the previous Written Answer on 8 November (WA 6). The wider impacts of the measure cannot be directly established from observable data, so are dependent on the assumptions about the behavioural response to the tax.
>
> The incidence of the tax must be borne by either the banks' shareholders or employees (through lower bonuses). The original costing by the previous Government when the measure was announced assumed the burden would be shared equally between the shareholders and the employees. This implies that bonuses would be reduced by 14 per cent compared to the level that would have been awarded without the BPT.

63 *Budget 2010*, HC 451 March 2010 para A.212
64 Office for Budget Responsibility, *Economic and fiscal outlook*, Cm 8036, March 2011 p103 (Table 4.7)
65 HC Deb 8 November 2010 c6WA

> Since the announcement of the tax, reports have indicated varying responses by banks, ranging from keeping bonuses more or less unchanged to passing on most of the cost of the BPT to staff. On balance, while it is clear that not all banks have significantly responded to the BPT, we have taken the view that there is insufficient evidence to justify changing the original assumptions on tax pass-through.
>
> Separately from the pass-though assumption, the costing includes a general behavioural response to allow for avoidance and labour supply effects as with other tax changes. The result of this is that bonuses subject to the BPT and income tax and NICs are assumed to have been 8 per cent lower than they would have been without the tax. Again this uses the same assumption made for the original costing when the measure was announced.
>
> For each £1 reduction in bonus income, there is a loss of 53.8p in income tax and national insurance contributions (NICs) collected from higher rate taxpayers. The combined effect of the two behavioural effects described above is to reduce income tax and NICs revenue by approximately £1.2 billion. This accounts for the difference between the gross and net estimates of yield from the BPT.
>
> Methodologies and general principles for calculating the cost or yield of Budget decisions are now set out in policy costing documentation. For Budget 2010, this is available here.[66]

2.4 Code of Practice on taxation for banks

Over this period, there was one more development related to the taxation of the banking sector. Following the G20 London Summit in March 2009, the then Chancellor, Alistair Darling, announced that HMRC would "publish shortly a draft code of practice on taxation for the banking sector, so that banks comply with not just the letter but the spirit of the law."[67] The *Financial Times* reported that it was generally expected that under the code, banks would be banned from using tax havens, and that there was concern that using the concept of the "spirit of the law" would "alter fundamentally the balance of power between banks and Revenue & Customs."[68] The then Financial Secretary, Stephen Timms, announced a consultation exercise on this code of practice three months later; part of Mr Timms' written statement is reproduced below:

> Banks play a vital role in the UK. They are important contributors of tax, and alongside firms in other sectors, banks will want to arrange their tax affairs efficiently. But it is clear that some banks have been involved in tax avoidance that goes well beyond reasonable tax planning. Given their access to capital and financial markets as well as their range of contacts, banks are uniquely placed to enter into transactions designed to avoid tax, offer transactions of this sort to their customers, or simply to provide the very large amounts of funding and other financial instruments these transactions can require. The

66 HL Deb 24 November 2010 ccWA336-7

67 HC Deb 16 March 2009 c654

68 "Banking code to outlaw use of offshore centres", *Financial Times*, 30 March 2009

> code seeks to change behaviours and attitudes towards tax avoidance in the banking sector.
>
> We, and the public, rightly expect banks, and financial services firms more generally, to show a high degree of responsibility, the highest standards of corporate governance and to have an open, transparent and professional relationship with HMRC. When the Government have provided significant support to strengthen the financial system, it is right that measures are taken to introduce a higher level of public transparency. This will not happen overnight and we need to work with the banks and other stakeholders to achieve it.
>
> This consultation is a starting point in changing the behaviour of banks in relation to tax avoidance. Over the coming months we will be speaking to banks to develop a shared understanding of where banks should draw the line, where we want them to raise and resolve issues with HMRC and to ascertain the appropriate level of accountability for behaviours at a senior level that they can achieve; and what they can expect from HMRC in return.[69]

The draft text proposed that banks would not "undertake tax planning that aims to achieve a tax result that is contrary to the intentions of Parliament." On this theme, the consultation document noted that "no country has found an agreed or enforceable definition of tax avoidance", although it went on to list a number of common features:

> [Avoidance] can involve:
>
> - exploiting loopholes in tax law;
> - juxtaposing two unrelated provisions in tax law in a way never intended or envisaged at the time the provisions were enacted; or
> - artificially creating the conditions for a tax relief or deferral;
> - and schemes, arrangements or transactions may:
> - use offshore vehicles in tax havens or elsewhere;
> - require arbitrage between UK and other countries' laws, often involving hybrid instruments or entities; or
> - take the form of other arrangements, the purpose of which is to achieve a tax advantage.[70]

For some, the need for this type of code was brought into stark relief by an expose by the BBC's Panorama programme in September 2009 that Lloyds Baking Group were regularly advising clients to avoid tax by channelling income offshore.[71] However, the professional accountancy bodies raised concerns that the code could undermine statute "as the governing force of

69 HC Deb 29 Jun 2009 cc1-2WS

70 *A Code of Practice on Taxation for Banks - Consultation Document*, 29 June 2009 pp17-18 [Commons Library Deposited paper 2009-1820]

71 "Tax inquiry into Lloyds offshore", BBC Panorama, 21 September 2009

taxation in the UK."[72] The Institute of Chartered Accountants pointed out that in cases where a bank is unsure if a tax result is contrary to the intentions of Parliament, the code anticipated the bank asking HMRC to set out its understanding of Parliament's intentions: "the interpretation of the meaning of the law should be a matter for the courts, and subject to a transparent appeals process."[73] Similar concerns were raised by the Law Society, and banks have suggested that it might simply drive business outside the UK.[74]

In December 2009 the final Code was introduced, though at the time there does not appear to have been any mention of when it would be adopted by individual banks: the Pre-Budget Report simply stated that "the Government expects all banks operating in the UK to adopt the principles set out in the Code of Practice."[75]

In its initial form the Code said the following about banks' approach to tax planning:

> 3. The bank should not engage in tax planning other than that which supports genuine commercial activity.
>
> 3.1. Transactions should not be structured in a way that will have tax results for the bank that are inconsistent with the underlying economic consequences unless there exists specific legislation designed to give that result. In that case, the bank should reasonably believe that the transaction is structured in a way that gives a tax result for the bank which is not contrary to the intentions of Parliament.
>
> 3.2 There should be no promotion of arrangements to other parties unless the bank reasonably believes that the tax result of those arrangements for the other parties is not contrary to the intentions of Parliament.
>
> 3.3 Remuneration packages for bank employees, including senior executives, should be structured so that the bank reasonably believes that the proper amounts of tax and national insurance contributions are paid on the rewards of employment.[76]

At this time of course the Labour Government announced its bank payroll tax, and debate over the taxation of this sector for the next few months focused on this one-off charge.

Following the new Government's announcement of a permanent levy on the banks, in October 2010 the Chancellor, George Osborne, confirmed that only four of the fifteen leading banks had signed up to the Code, but that HMRC would require the other eleven to do so by the end of the next month.[77]

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72 Chartered Institute of Taxation press notice, *Tax must be levied according to the law, not by code or intention*, 23 September 2009

73 ICAEW, *A Code of Practice on Taxation for Banks*, TAXREP 50/09, 23 September 2009 para 13

74 "Banks hit back at tax avoidance crackdown", *Financial Times*, 23 September 2009

75 *Pre-Budget Report*, Cm 7747 December 2009 para 3.41

76 HMRC, *Code of Practice on Taxation for Banks*, 2009. HMRC collates guidance on the Code of Practice on Gov.uk.

77 HC Deb 20 October 2010 c956; HM Treasury press notice 66/10, *Top 15 banks sign Code of Practice*, 30 November 2010

Subsequently, as discussed below, the Coalition Government introduced changes to the Code, to provide a legal basis for the naming of non-compliant banks and for HMRC to publish an annual report on its operation.[78]

[78] For more details on these developments see, *The Code of Practice on Taxation for Banks Annual Report 2015*, December 2015. See also, "HMRC warns banks on tax avoidance", *Financial Times*, 19 October 2017 & "The latest on the banking code of conduct on tax", *Tax Journal*, 17 November 2017.

3 The Coalition Government's bank levy

3.1 Budget 2010

During the 2010 Election campaign both the Conservative Party and the Liberal Democrats proposed a new tax on banking. In their manifesto, the Conservatives stated, "we will put in place a levy on banks. We are prepared to act unilaterally if necessary, but there is emerging international agreement on this approach and the US and German governments have both announced similar plans."[79] In their manifesto, the Liberal Democrats had stated that they would introduce a levy "so that banks pay for the financial support they have received, until such time as they can be split up in order to insulate retail banking from investment risks."[80] In turn the new Government mentioned this as one of its priorities for the tax system in the agreement underpinning the Coalition: this stated that the Government would "introduce a banking levy and seek a detailed agreement on implementation."[81]

In his first Budget on 22 June 2010 the Chancellor George Osborne announced a new bank levy to be introduced from January 2011:

> The failures of the banks imposed a huge cost on the rest of society, so I believe that it is fair and right that in future banks should make a more appropriate contribution, reflecting the many risks that they generate. Such an approach has already been recommended by the International Monetary Fund. We are exploring the costs and benefits of a financial activities tax on profits and remuneration, and we will work with international partners to secure agreement, but today the British Government take the initiative in this global debate about the appropriate risks and rewards in international banking.
>
> From January 2011, we will introduce a bank levy. It will apply to the balance sheets of UK banks and building societies, and to the UK operations of banks from abroad. There will be deductions for tier 1 capital and insured retail deposits, and a lower rate for longer maturity funding. Smaller banks with liabilities below a certain level will not be liable for the levy. Once fully in place, we expect the levy to generate over £2 billion of annual revenues.
>
> There are those who have argued whether we should wait until every country in the G20 introduces a bank levy. I believe that is not reasonable or fair. Indeed, I can tell the House that the French and Germans have joined the UK today in committing to introduce a bank balance sheet levy. In a joint statement, our

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[79] *Conservative Party Manifesto 2010: Invitation to join the Government of Britain*, April 2010 p29

[80] *Liberal Democrat Manifesto 2010: Change that works for you*, April 2010 p16

[81] HMG, *The Coalition: our programme for government*, May 2010 p9

> three Governments have pledged to ensure our banks make a fair contribution to reflect the risks they pose.[82]

Further to this the Budget report suggested that the levy would "result in a rebalancing of the burden of taxation between banking and other sectors", and that further details would be published late in the year following consultation.[83] There was a limited response to the announcement – as one practitioner noted in the *Tax Journal*, "a bank levy was widely trailed and the market reaction indicated that the levy was at the more modest end of expectations."[84]

In his Budget speech the Chancellor also announced a programme of reform to the corporate tax system, including a staged reduction in the main rate of corporation tax from 28 per cent to 24 per cent over the course of four financial years from April 2011. This was projected to cost £2.7 billion by 2014/15, whereas the new levy was projected to raise £2.4 billion by 2014/15.[85] This lead to some criticism that the levy would have no impact on the banks.

During the Committee stage of the Finance Bill after the Budget, Chris Leslie MP, speaking for the Labour Party, said, "I do not think any Members are opposed in principle to the banking levy that the Chancellor announced, although many might question whether it is tough and stringent enough", but went on to argue that the cut in corporation tax should not apply to the banking sector:

> Surely few issues can highlight the unfairness and injustice of the Government's Budget more effectively than the suggestion that, of all the sets of institutions that should benefit from more advantageous tax arrangements, the banks should be given such a windfall at such a time … Irrespective of whether a particular bank received a direct sum from the taxpayer, all those banking institutions benefited from the implicit and implied safety net that the taxpayer provided. Were it not for that underwritten implicit guarantee, banks such as Barclays and others would have been in significant trouble. They may not have taken the handout themselves, but had the markets not felt that the Government of the day were prepared to act were they so requested or had it been necessary to do so, all those banking institutions would have been in an entirely different position.[86]

In response to this Treasury Minister David Gauke argued that the Government's approach was a targeted one, to raise additional revenue "while enabling banks to lend more." He pointed out that the projected receipts from the levy would be far greater than the amounts the sector would gain from the cut in corporation tax:

> The levy is a surgical approach, intended to encourage banks to move to less risky funding profiles, and a contribution reflective of economic risk. A tax

82 HC Deb 22 June 2010 cc175-6

83 *Budget 2010*, HC 61, June 2010 para 1.63

84 "Budget analysis: Banks", *Tax Journal*, 5 July 2010; see also "Muted mutterings from the City but no big stink", *Financial Times*, 23 June 2010

85 *Budget 2010*, HC 61, June 2010 paras 1.61 & 1.63; p40 (Table 2.1 - items 3 & 8)

86 HC Deb 12 July 2010 c711, c719

> based simply on profits, such as corporation tax, is not related to risk and will not create the behavioural effect that we believe the banking levy will achieve …
>
> We have heard concerns that the corporation tax would cancel out the effect of the bank levy or offset it … We have the numbers only until 2014-15, and I should point out that the financial services sector is somewhat broader than just banks. It includes insurance, pension funds and auxiliary financial services, so the numbers refer to the corporation tax cost not only for banks, but for other financial services. However, I will compare those with the bank levy yield.
>
> For 2011-12, the corporation tax costs will be £0.1 billion, whereas the bank levy yield will be £1.15 billion; for 2012-13, corporation tax costs will be £0.2 billion, compared with a bank levy yield of £2.32 billion; and for 2013-14, corporation tax costs will be £0.3 billion, compared with a £2.5 billion additional yield from the bank levy; and for 2014-15, the corporation tax costs will be £0.4 billion, compared with a bank levy yield of £2.4 billion. Even in this last year, where the differential is at its narrowest, we can see that it has not been cancelled out or offset. There is no cashback, and the banks are not quids in as a consequence …
>
> We are requiring the banking sector to pay at least £2 billion more in tax as a consequence of these proposals. That is not a minor matter. Other sectors, including manufacturing, will benefit from the reduction in corporation tax, but the banks will not benefit because we are introducing the bank levy.[87]

When the Treasury Committee took evidence on the Budget, Andrea Leadsom MP asked Roger Bootle at Capital Economics, and John Whiting of the CIOT, about whether the levy had given the banks an 'easy ride', or if it would damage their ability to lend to business:

> **Q113 Andrea Leadsom**: … Do you think that the banks have had an easy ride with this bank levy combined with the reduction in corporation tax, or do you think that this has done more damage to banks' ability to lend particularly to SMEs, which I think is the area that we are most concerned about?
>
> **Mr Bootle**: Well, it does not help in terms of taking resources from the banks, and it is very difficult, I think, to argue that banks should be lending more and at the same time asking them to hold more capital and/or imposing some sort of levy on them; these things are actually in contradiction. However, the amounts are not huge, I have to say, and I would regard this as more of a gesture, but in relation to the reaction of the banks, it is a gesture that does not help because all the time of course the banks are fearful of how the climate is developing with regard to their own activities, so many of them are worried that we are moving into a regime in which the political environment is very unfriendly to the activities that they wish to undertake, so they think about reducing the scale of those activities or even moving them elsewhere.
>
> **Mr Whiting**: As a comment from a tax point of view, you are absolutely right to link the bank levy with the reduction in corporation tax rates, because there is an element here for the profitable banks that the levy will claw back what would have otherwise been a bit of a bonus for the profitable banks with the reduction in corporation tax rates. There is, clearly, a lot of worry amongst the

[87] HC Deb 12 July 2010 c735, cc733-4

> international banks that this levy will be matched by similar levies in other countries which then will not offset and it will all be cumulative.
>
> As Roger has alluded to, there is also a worry that this is also adding to the amount of extra regulation that is on the banks. Also that it is setting a bad atmosphere and it is not giving them the confidence to do the extra lending to, as has been said, the small- and medium-sized sector which, in many ways, is the one that is most wanting finance, so there is quite a lot of things swirling around. The good thing about the levy is that there is active discussion with the banking sector about its design to try to minimise the burdens, but what actually comes out remains to be seen.[88]

In evidence to the Committee the Chancellor explained why the design of the levy was focused on raising a particular sum for the Exchequer, rather than a given rate of tax:

> The bank levy is designed to do two things. The first is to ensure there is a price … paid for the implicit insurance that we all offer as taxpayers for the wholesale funding of banks, which became pretty explicit in the middle of the crisis. That is why, for example, insured deposits are not included in the tax base for the bank levy. It is, in effect, a tax on wholesale funding. One of the things we have learnt from the crisis is you do not want banks with very large exposures to wholesale markets, they need a more stable basis for funding long-term. …
>
> The other reason, to be absolutely frank, was for reasons of equity. Asking the general population to accept a VAT rise, asking them to accept that there were going to be changes to welfare eligibility and the like, doing these things is a difficult thing for any government to do but I thought it would be totally inappropriate not to ask the banking sector to make a contribution as well. I think it is appropriate to have a tax on banks and I have tried to do it in a way that follows international best practice.
>
> When it is fully operational the bank levy is going to raise £2.5 billion and we made it clear that we are targeting a revenue sum rather than a particular rate because we think that is an appropriate contribution that balances fairness with the competitiveness of the UK banking sector. That sum of money, when it is put alongside some of the impacts of capital requirement changes, is relatively small. What is driving things at the moment is not so much the requirements of regulators but the requirements of the markets.[89]

3.2 Consultation on the design of the levy

In July 2010 the Government published a consultation document on the design of the levy,[90] signalling that it aimed to publish final draft legislation for inclusion in *Finance Bill 2011* by the end of the year.

The paper summarised the structure of the levy as follows:

[88] *The June 2010 Budget*, 20 July 2010 HC 350 2010-11 Q113 Ev14-15

[89] *op.cit.* Qs270, 272 (Ev39-40)

[90] HC Deb 13 July 2010 c23WS

> The Levy will apply to:
>
> - the global consolidated balance sheet of UK banking groups and building societies;
> - the aggregated UK subsidiary and branch balance sheets of foreign banks and
> - banking groups operating in the UK; and
> - the balance sheets of UK banks in non-banking groups.
>
> These institutions and groups will only be liable for the Levy where their relevant aggregate liabilities, as set out below, amount to £20 billion or more. In calculating branch liabilities and Tier 1 capital, the Government proposes to use the principles applied to the existing capital attribution methodology used for Corporation Tax purposes.
>
> The Levy will be based on total liabilities and equity excluding:
>
> - Tier 1 capital;
> - insured retail deposits;
> - repos secured on sovereign debt; and
> - policyholder liabilities of retail insurance businesses within banking groups.
>
> The Government proposes that derivative positions will be included on a net liability basis.
>
> It is proposed that the Levy will be set at 0.07 per cent which is expected to raise around £2½ billion annually. However, there will be a lower rate of 0.04 per cent for 2011. There will also be a reduced rate for longer-maturity funding (i.e. greater than one year remaining to maturity at the operative balance sheet date) to be set at 0.02 rising to 0.035 per cent; half the main rate.
>
> The Levy will not be deductible for Corporation Tax.
>
> HM Revenue and Customs will administer the Levy.[91]

An initial response was published in October,[92] and reactions were split between the banking sector which raised concerns about the interaction of the levy with any similar levy that might be introduced in other countries,[93] and commentators who had wished that the levy would raise much more.[94] A *Financial Times* editorial suggested that although the levy put the UK ahead of other countries in terms of its response to the financial crisis, "the proposal is hardly a big leap":

> If the goal were to capture the economic rent or value added generated by the industry, the right tax base would be the sum of compensation and dividends.

91 HM Treasury, *Bank Levy – a consultation*, July 2010 pp6-7
92 HC Deb 21 October 2010 cc57-8WS. See also HMT, *Bank levy – consultation response*, October 2010
93 "New levy set to hit big banks the hardest", *Financial Times*, 22 October 2010
94 eg, "Banks appear to have wriggled off the hook", *Guardian*, 22 October 2010

> So this is a tax to make banks pay for the support they receive and the risks they impose on others. In that perspective it looks decidedly timid. Andrew Haldane of the Bank of England estimates the subsidy to British banks at an average £59bn over the last three years. The proposed levy will raise one-twentieth of that.
>
> Banks' predictable cry of despair will really be a sigh of relief.[95]

One important change to the design of the new levy was the decision to replace the threshold for triggering a bank's liability with an allowance, as explained in the Government's summary of responses it had had to the consultation:

> 3.4 Like any tax measure, the Levy needs to be proportionate, and it was therefore proposed that there should be a threshold of £20 billion in liabilities below which banks would not be subject to the Levy. The aim was to balance the probability that the firm would pose a systemic risk, which is correlated with size, against the relative burden imposed in order to gather additional revenue at the margin. However, the consultation document sought views on whether it would be preferable to make it an allowance instead of an all-or-nothing threshold in order to avoid adverse incentives on banks close to the threshold, even though that would require a higher rate to raise any given amount of revenue.
>
> 3.5 Respondents were generally of the view that the threshold would create potent incentives for banks around the margin to structure their business in certain ways, or disincentives to grow, in order to avoid crossing the threshold. Indeed some argued that the threshold would probably not achieve any higher yield than an allowance because of these effects. The Government accepts this argument and has therefore decided that there should be an allowance on the first £20 billion of liabilities liable to the Levy (this will apply to long and short maturity liabilities according to the proportion on the balance sheet after exempted items, netting, etc).[96]

At this time the Commons was considering a second Finance Bill – composed of a series of technical measures postponed from the March 2010 Budget. At its report stage the Opposition took the opportunity to raise the issue of the bank levy: Chris Leslie suggested that "although the banking levy is in principle welcome, it is now patently obvious that it has been set at a woefully inadequate level."[97] In response the then Economic Secretary Justine Greening alluded to the fact that the levy was a permanent tax, unlike the bank payroll tax, and that the Government were also taking action against tax avoidance in this sector:

> We were the first country in the G20 to take such action … we have been joined by France and Germany, which made announcements on bank levies in June. Germany's plans for its bank levy have been before Parliament there, while France outlined the details of its bank levy at its budget in September. Hungary, Portugal and Austria have since also outlined plans to introduce bank levies, while Sweden has already introduced a levy. Our bank levy is a

[95] "Editorial: Osborne's levy is not all that taxing", *Financial Times*, 22 October 2010

[96] *Bank levy – consultation response*, October 2010 p11. See also, HC Deb 5 May 2011 cc 910-1W

[97] HC Deb 8 November 2010 c75

> permanent one and a regular source of revenue-unlike the one-off bonus tax of the previous Administration ...
>
> In fact, over and above the bank levy, the Government are taking a tougher approach to tackling tax avoidance by the banks. Prior to the spending review, only four of the top 15 banks had adopted the previous Government's code of practice. We have asked Her Majesty's Revenue and Customs to work with banks to make sure they adopt and implement the code by the end of this month, thereby making the commitment to comply with both the letter and the spirit of the law, and not to engage in or promote tax avoidance.[98]

In December the Government published a final draft of its legislation, which including setting the rate of the levy slightly higher than initially intended (at 0.05% in the first year rising to 0.075%, rather than 0.04% and 0.07%), though the forecast annual yield remained £2.6 billion. HMRC gave some details of the impact of the levy in a tax information note accompanying the draft legislation:

> The Levy will strengthen incentives for banks to increase their Tier 1 capital, longer-term funding, retail deposits and liquid assets. The Levy therefore complements wider regulatory reforms aimed at improving financial stability, including higher capital and liquidity standards. In the forecast period we expect any incremental improvements in banks' funding profiles as a result of the Levy to be small but to be rising toward the end of the forecast period. This reflects the current regulatory pressures banks already face to increase their capital, the challenging conditions in funding markets and competitive pressures for banks to increase their share of retail deposits. These factors are also reflected in the lower initial rate for 2011. ...
>
> The Levy will affect between 30 and 40 banks, building societies and banking groups. The Levy has been specifically designed to ensure a level playing field; the Levy applies to the aggregated liabilities of the UK business and subsidiaries of foreign bank groups to ensure that a fair measure of the UK's exposure to that group can be determined and to provide a consistent basis with UK banks.[99]

Reactions to this latest announcement were much as before.[100]

3.3 Budget 2011

In the New Year details on the bonus arrangements at some banks lead to calls for the reintroduction of the bank payroll tax from, among others, Ed Miliband, then leader of the Labour Party.[101] The issue arose at Prime Ministers Questions on 12 January 2011:

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98 HC Deb 8 November 2010 c88. The Treasury confirmed that this had happened at the end of the month (HM Treasury press notice, *Top 15 banks sign Code of Practice*, 30 November 2010).

99 HMRC, *Bank Levy – tax information & impact note*, 9 December 2010

100 "Campaigners condemn 'soft' banking levy", *Guardian*, 10 December 2010 & "Treasury raises tax bill for big banks", *Financial Times*, 10 December 2010

101 "Miliband calls for repeat of bonus tax", *Financial Times*, 11 January 2011

> **Edward Miliband**: ... Labour's payroll tax on the banks raised £3.5 billion in addition to the corporation tax that they pay. [The Prime Minister's] banking levy is raising just £1.2 billion. In anyone's language, that is a tax cut for the banks. Why does the Prime Minister not just admit it?
>
> **The Prime Minister**: ... The bank bonus tax raised a net £2.3 billion, and the author of that tax, the former Chancellor, the right hon. Member for Edinburgh South West (Mr Darling), who is sitting on the Back Benches, says that you cannot go on introducing this tax year after year, and very sensible that is too. The bank levy will raise £2.5 billion each year once it is fully up and running ... we will raise £9 billion compared with his £2.3 billion. Even the shadow Chancellor can work out that 9 is bigger than 2.3.[102]

On 8 February the Chancellor announced a relatively small increase in the levy in its first year of operation to 0.075%; to take account of the fact that banks were currently paying the levy at 0.05%, the levy would be set at 0.1% for March & April 2010. As a consequence the levy would raise an additional £800m in 2011 (calendar year).[103]

The Government's decision appears to have been driven by frustration over its negotiations with the sector on bankers bonuses,[104] though as the BBC's business editor Robert Peston commented, "the £800m increment is a rounding error in respect of the ballooning national debt ... the tax rise is probably of more importance from a symbolic point of view ... rather than from a budgetary perspective."[105] In an editorial the *Times* acknowledged that the decision made sense "politically, given the level of public anger" but "asking the banks to pay extra tax ... while simultaneously asking them to lend more on the one hand, and to hold more capital on the other, is not an entirely coherent policy."[106]

In his 2011 Budget the Chancellor announced an additional 1% cut in the main rate of corporation tax, but went on to confirm that the rates of the bank levy would be increased, to offset the impact of this tax cut for the banking sector:

> From April this year, corporation tax will be reduced not just by the 1% I previously announced, but by 2%, and it will continue to fall by 1% in each of the following three years, taking our corporate tax rate right down to 23%-16 % lower than America, 11% lower than France and 7% lower than Germany-the lowest corporation tax in the G7 ...
>
> To ensure that this is not a net tax cut for banks, I am adjusting the bank levy rate next year to offset its effect. In each and every year of this Parliament, our permanent bank levy raises more in any one year than the last Parliament's bank taxes.[107]

102 HC Deb 12 January 2011 c280
103 HM Treasury press notice 14/11, 8 February 2011
104 "Change follows failure over bonuses and loans", *Financial Times*, 9 February 2011
105 "Chancellor raises additional £800m from bank levy", *BBC News*, 8 February 2011
106 "Leader: The Money Game", *Times*, 9 February 2011
107 HC Deb 23 March 2011 c955. *Budget 2011* HC 836 March 2011 para1.90

Details of this tweak to levy rates were given in a tax information note published alongside the Budget report: [108]

> The Chancellor has today announced an increase in the Levy rates from 1 January 2012 onward. The rates for 2012 onwards will now be 0.078 per cent for short-term chargeable liabilities and 0.039 per cent for long-term chargeable equity and liabilities...
>
> The rates are:
>
> - 01 January 2011 – 28 February 2011 : 0.05 per cent for short-term chargeable liabilities and 0.025 per cent for long-term chargeable equity and liabilities.
> - 01 March 2011 – 30 April 2011 : 0.1 per cent for short-term chargeable liabilities and 0.05 per cent for long-term chargeable equity and liabilities.
> - 01 May 2011 – 31 December 2011 : 0.075 per cent for short-term chargeable liabilities and 0.0375 per cent for long-term chargeable equity and liabilities.
> - 1 January 2012 onwards : 0.078 per cent for short-term chargeable liabilities and 0.039 per cent for long-term chargeable equity and liabilities.
>
> The Levy will not be charged on the first £20 billion of chargeable liabilities. This first £20 billion of liabilities not charged to the Levy will be apportioned between long and short maturity liabilities in accordance with the proportions of each within the total chargeable equity and liabilities for a chargeable period ...
>
> In December 2010 when the initial draft rates were included in the draft Finance Bill the yield shown in the accompanying TIIN for the Levy was forecast to be:

2011-12	2012-13	2013-14	2014-15	2015-16
+1,260	+2,320	+2,550	+2,560	+2,560

> The increase in the Levy rates for 2011 announced on 8 February, plus the rate increase from 2012 announced today, therefore increases the total forecast yield for the Levy to the following:

2011-12	2012-13	2013-14	2014-15	2015-16
+1,890	+2,610	+2,650	+2,670	+2,660

There was limited reaction to the announcement,[109] as commentators focused on other aspects of the Budget.

[108] HMRC, [Bank levy – tax information & impact note](), 23 March 2011

[109] "Banks fail to cheer cut in corporation tax", *Financial Times*, 24 March 2011

Provision to introduce the levy was included in the Finance Bill (specifically clause 72 & schedule 19),[110] and debated at the Committee stage of the Bill on 3 May. Speaking for the Opposition Chris Leslie argued that the yield from the levy would be far too low, given the approach taken in other countries, and the monetary value to the banking sector of the support it had received from the taxpayer:

> The bank levy is a sensible idea in theory, and we broadly support it. However, the yield suggested in the Bill—only £2.6 billion—is not just small but pathetic by international standards when compared with the rate being pursued in other countries. It is perplexing that Ministers settled on that figure, and there has never been any evidential basis published for why they did so …
>
> Compared with the substantial amounts of taxpayers' money put up in the bail-out of the banks—£76 billion of shares purchased in the Royal Bank of Scotland and Lloyds, £250 billion of guarantees, another £280 billion of other insurances, and a further £100 billion of annual implied subsidy, according to the Bank of England—a £2.6 billion bank levy is very puny …
>
> I wish to talk about the rate at which the Government have chosen to set the bank levy, because it is a low rate by international standards. It is less than a third of the level that has been set in France, for example. Ministers will know that the rate varies in a number of jurisdictions, but I think that it is 0.25% in France. The levels involved are still quite small, but in Hungary it is 0.53%, in the USA it is 0.15%—although, as I said, it has not been enacted at this point—in Portugal it is 0.1%, and so on. It is to be only 0.078% here in the UK for short-term liabilities, and 0.039% for long-term liabilities, which is very small by international standards.[111]

Mr Leslie also argued that the Government should reintroduce a tax on discretionary bonuses, given that there was little evidence that banks had left the UK to avoid the tax: "Did the banks collapse as a result of the bonus levy? No. Did they all flee abroad to relocate somewhere else, as threatened? Absolutely not. So, too, with the continuing scale of the bonus pot, which has hardly changed at all, it is absolutely right that we look to reinstitute the levy this year, along with a decent bank levy, as we are discussing today."[112]

Later in the debate Andrew Love MP made a similar criticism, contrasting the anticipated yield from the levy with the size of the implicit subsidy to the banking system from the Government's actions to ensure none of the major banks failed: "the Bank of England has done some work and suggests that there is a £100 billion subsidy; others have suggested lower figures, but there is consensus that the figure is very substantial. If the bank levy will raise only one twentieth or one fortieth of that sum, that puts the matter in context."[113]

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110 These provisions form s73 & schedule 19 of the *Finance Act 2011*. For a summary of the scope of the tax see, "FA 2011 analysis: Bank Levy", *Tax Journal*, 5 August 2011

111 HC Deb 3 May 2011 c482, c485

112 *op.cit.* cc481-2

113 *op.cit.* c521. On this see, Public Accounts Committee, *Maintaining financial stability of UK banks: update on the support schemes*, HC 973 of 2010-12, 20 April 2011

In response the Treasury Minister Mark Hoban argued that it was misleading to compare the rates of various bank taxes in other countries:

> The hon. Member for Nottingham East (Chris Leslie) made great play of the various rates that other countries were introducing. Let me point out to him, then, that in France the levy is expected to raise only €500 million. In Germany, the levy is expected to raise €1 billion annually. The hon. Gentleman prayed in aid the US on two occasions, but the US has not yet introduced legislation, so his comments are empty.

The Minister went on to argue that the levy had to be seen in the wider context of the Government's actions to reform the banking system, addressing Mr Love's point about the value of the implicit guarantee given to banking system:

> The levy should not be seen in isolation from other reforms to the banking system. Domestic, European and international banking reforms will change the landscape of banking. For example, Basel III will lead to higher capital levels, and its liquidity reforms will change the funding profiles of banks. There is a vigorous debate within the EU and the G20 about whether the holders of bank debt should be required to contribute to the recovery or resolution of banks, for example through the conversion of debt to equity [In addition] ... we have established an independent commission on banking to consider structural and related non-structural reforms.
>
> The hon. Member for Edmonton (Mr Love) raised issues to do with the implicit guarantee, to make sure the right reforms are in place so banks are not dependent on the guarantee from the taxpayer. We have tackled that issue, whereas when his party was in government, it failed to do so. I wish he would give us some credit for the action we have taken to reform the regulation of the banking system during the year in which this Government have been in office.[114]

At the close of the debate, an Opposition amendment to require the Government to publish a formal review of the rate of the levy, and the Government's general approach to bank taxation, was negatived by 296 votes to 153.

In the weeks after the 2011 Budget the question of taxing the banks continued to be the subject of spirited debate. In a speech on the Labour Party's economic policy in June 2011, the then Shadow Chancellor, Ed Balls, argued that "repeating the bank bonus tax" would raise £2 billion, and could be used, along with a temporary cut in the standard rate of VAT, to boost the economy.[115] An EDM supporting the introduction of such a tax "at the earliest opportunity", put down by Kate Green MP at the same time as Mr Ball's speech, was signed by 64 Members.[116] For its part the Government continued to argue that a bonus tax would be counterproductive – as the then Financial Secretary suggested at Treasury Questions that month:

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[114] *op.cit.* c549, cc551-2. For more background see, *Financial markets: supervisory and structural reform*, Commons Library briefing SN5934, 23 December 2011.

[115] "Transcript of Ed Balls speech on the economic alternative", *New Statesman*, 16 June 2011

[116] EDM 1940 of 2010-12, 16 June 2011

> **Paul Blomfield**: What assessment he has made of the level of taxation of banks.
>
> **The Financial Secretary to the Treasury (Mr Mark Hoban)**: Banks operating in the UK make a significant contribution to the economy and public finances. However, as the financial crisis demonstrated, the sector also posed a potential risk to the wider economy and it is only fair for the banks to make an additional contribution to reflect that. That is why we have implemented a permanent levy on the balance sheet of banks, which will raise more than £2.5 billion each year.
>
> **Paul Blomfield**: I thank the Minister for that reply, but will he recognise the enormous feeling throughout the country that the banks need to fulfil their responsibility for the challenges we face? Will he therefore explain the stubborn refusal of the Government to repeat last year's bonus tax, on top of the bank levy, which would generate the revenue to build 25,000 affordable homes and create 100,000 new jobs?
>
> **Mr Hoban**: Perhaps the hon. Gentleman should speak to the right hon. Member for Edinburgh South West (Mr Darling), who said that imposing the bank levy again simply would not work.[117]

The Opposition made its case for reintroducing a bonus tax again at the report stage of the Finance Bill in July 2011. On this occasion, Chris Leslie MP argued that having this alongside the bank levy "would be a fair contribution from the banking sector", given the financial sector would gain from cuts in the main rate of corporation tax:

> The sector will have a tax cut of £100 million in 2011-12, £200 million in 2012-13, £300 million in 2013-14, and £400 million in 2014-15. That is a £1 billion corporation tax cut over this Parliament. The Treasury ought to supplement its very modest bank levy plan with the bank bonus tax because it is only fair that those who played such a central role in the global economic downturn make a greater contribution to help to secure the economic recovery by supporting jobs and growth.[118]

In response Mark Hoban, the then Financial Secretary, argued "we do not need a bank payroll tax. We have demonstrated that the bank levy we have introduced will ensure that banks pay a fair share in relation to the risk they pose to the wider economy." The Minister went on to give more details of how the UK's levy compared with the levy introduced by the French government:

> Even allowing for the larger size of the UK banking sector, the UK levy is larger than that of France or Germany. Different levies cannot be compared by looking just at headline rates; for example, the UK levy is focused on balance sheet liabilities, while the French levy is on risk-weighted assets.
>
> Furthermore, unlike the UK levy, the French levy does not apply to branches of foreign banks. Consequently, the French levy is expected to raise between €500 million to €1 billion a year, much less than the £2.5 billion we shall raise in the UK, a difference that cannot simply be explained away by the different

117 HC Deb 21 June 2011 c153

118 HC Deb 5 July 2011 c1383

> sizes of our banking sectors. Moreover, unlike the UK, the French levy is deductable from their corporation tax liability.[119]

It is worth noting that at this time HMRC launched a new annual statistical publication which gave details of tax receipts from the banking sector.

3.4 Levy rate increases from 2012 to 2015

In September 2011 the European Commission published proposals for an EU-wide tax on financial transactions (FTT) – or a 'Tobin tax' as this type of tax is often called. Although the idea received strong support from some EU States, the Coalition Government took the position that such a tax would only be viable if implemented on a global scale, and that the UK's own banking levy met some of the aims set for an FTT without its considerable drawbacks.[120]

In a report published in March 2012 the Lords Economic Affairs Committee noted, "whilst we acknowledge the strength of public anger against the financial sector, and the widespread view that a form of taxation should be introduced to ensure that those who contributed to the current crisis should contribute to its costs, it is important to recognise that not all elements of the financial sector bear equal (or even any) responsibility for the crisis. Caution should therefore be observed before introducing any proposal that would have a blanket effect on all elements of the financial sector."[121]

In January 2013 eleven Member States agreed to proceed with an FTT[122] - the UK not being one of them – and the Commission published details of the potential scope of this tax.[123] However, progress on the initiative proved to be slow, with concerns that the tax might be legally defective, and difficulties in the negotiations between participating States.[124]

In his Autumn Statement on 29 November 2011, the Chancellor announced that the rates of the bank levy would be increased to ensure that the tax would raise at least £2.5 billion a year, as initially proposed – while reiterating the Government's opposition to a new EU FTT:

> It is this Government's policy to ensure that we remain the home of global banks and that London is the world's pre-eminent financial centre. That is why we will not agree to the introduction of an EU financial transaction tax. It is not a tax on bankers; it is a tax on people's pensions. Instead, we have introduced a permanent bank levy to make sure that the banks pay their fair share. I have always said that we wished to raise £2.5 billion each and every year from this

119 HC Deb 5 July 2011 c1419, c1418. Mr Leslie moved an amendment to require the Government to publish a review on the case for a payroll tax, but this was negatived by 288 votes to 215.

120 *Forty-fourth report*, HC 428-xxxix of 2010-12, 2 November 2011 pp 15-24

121 *Towards a Financial Transaction Tax?*, HL Paper 287 of 2010-12, 30 March 2012, para 29

122 European Finance Council (ECOFIN) press notice 555/13, 22 January 2013

123 European Commission press notice IP/13/115, 14 February 2013

124 For further background on the debate at the time see, *The Tobin Tax : recent developments*, Commons Library briefing CBP6184, 15 May 2014.

> levy. To ensure we do that, I need to raise the rate of the levy to 0.088%. That will be effective from 1 January next year.[125]

HM Treasury estimated that this change would raise £280m in 2012/13, rising to £310m in 2013/14, and as part of its assessment, stated that it did not expect any additional behavioural change on the part of the banks that would affect revenues – such as increased avoidance activity.[126] A few days after the Chancellor’s statement the Treasury published draft legislation for the *Finance Bill* in 2012, including provision for the increase in levy rates.[127]

Few commentators discussed this change in the levy in their reactions to the Chancellor’s statement, though Robert Peston, then business editor at the BBC, suggested that even though British bankers were likely to be “incandescent with fury”, it was unlikely that any of the major UK banks would relocate to reduce their liability:

> Bankers would say it is much harder for them to set their budgets and plan where to invest in a rational way if the tax rate keeps changing every few months. More pertinently, an increase in the tax rate will hit the big British banks hardest, because - unlike their overseas rivals - the levy applies to all their borrowings, on a worldwide basis, not just their UK borrowings. Which means their levy payments will rise both in absolute and relative terms: the burden on British banks will increase …
>
> Certainly in the case of the semi-nationalised banks, Lloyds and Royal Bank of Scotland, they'll have to pay the extra tax and lump it. But, in theory, Barclays, Standard Chartered and HSBC have the option of paying a lower amount by moving their respective domiciles, their homes, offshore (to be clear, they'd still have to pay a fair whack, because they would still have taxable debt in the UK). The Treasury's calculated gamble is that none of them will do this. And there is good reason to believe the Treasury is right … Barclays and HSBC … could only move if they were able to identify a new national base with all of the following characteristics:
>
> 1) It would have to be a big economy, with a central bank whose financial resources were sufficiently large to bail out these huge banks in a crisis; 2) The relevant government in the new home would have to be stable and democratic; 3) The burden of regulation and tax would have to be less than in the UK; 4) The precise choice of new home would not massively annoy customers or government in a different part of the world that is vital to said bank's interests (for example, choosing the US would not go down well in China).
>
> Now when you look at the alternatives available to Barclays and HSBC - China, Hong Kong, Singapore, the US, the eurozone, Switzerland, parts of the Middle East - they fail some or all of the four tests. So the Treasury may be right that Barclays and HSBC may grump, but they'll have to swallow the bitter levy pill and like it.[128]

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125 HC Deb 29 November 2011 c805; *Autumn Statement 2011*, Cm 8231, November 2011 para 1.135

126 HMT, *Autumn Statement 2011 policy costings*, November 2011 p15

127 HMRC, *Bank levy: rate change – tax information & impact note*, 6 December 2011

128 “Bankers hit by third levy increase”, *BBC News*, 29 November 2011

In the run-up to the 2012 Budget the wider question of the banking sector's attitude to the tax system came into the headlines with the announcement that the Government would introduce anti-avoidance provisions with immediate effect, apparently as a response to two schemes marketed by Barclays Bank.[129] In one case the legislation would have retrospective effect, and in the Ministerial statement confirming this change, the Exchequer Secretary referred to the Code of Practice on Taxation of Banks in justifying this decision.[130]

Subsequently the Treasury Committee, in their report on the 2012 Budget, raised concerns over these proposals and argued that "the Government restrict its use of retrospective legislation to wholly exceptional circumstances, which should be narrow and clearly-defined." In its response the Government noted that its approach – as set out in a protocol on such unscheduled announcements[131] – remained that such changes were 'wholly exceptional' but that the statement in February had been "appropriate and proportionate":

> Previous ministerial announcements made it clear that the Government's policy and intention in introducing the legislation was that the profits in question were intended to be taxed; and the bank had signed up to the Code of Practice on Taxation for Banks, under which it agrees not to involve itself in this sort of aggressive avoidance.[132]

By contrast, there was much less discussion over the bank levy, and there was little reaction to the announcement by the Chancellor in his 2012 Budget that the rates would be amended a fourth time – to take account of a further cut in the rate of corporation tax:

> The headline rate of corporation tax remains the most visible sign of how competitive our country is. We have already cut the rate from 28% to 26%. This April it is due to fall again to 25%. I can tell the House today that we will have a further cut of 1%, to be implemented right away.
>
> From next month, Britain will have a corporation tax rate of just 24%, and we will continue with the two further cuts planned next year and the year after, so that by 2014 Britain will have a 22% rate of corporation tax. That is the biggest sustained reduction in business tax rates for a generation—a headline rate that is not just lower than our competitors, but dramatically lower: 18% lower than the US, 16% lower than Japan, 12% below France and 8% below Germany.
>
> That is an advertisement for investment and jobs in Britain, and it is a rate that puts our country within sight of a 20% rate of business tax that would align basic rate income tax, the small companies rate and the corporation tax rate.

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129 "'Abusive' Barclays tax plans blocked", & "Barclays' tax plans clash with sentiment", *Financial Times*, 28 & 29 February 2012.

130 HC Deb 27 February 2012 cc5-6WS

131 For details see, HM Treasury, *Tackling tax avoidance*, March 2011 pp17-21

132 Treasury Committee, *Second special report*, HC 422 of 2012-13, 31 August 2012 pp7-8. The issue was raised when one of these provisions was considered at the Bill's Committee stage (Public Bill Committee, *Tenth Sitting*, 12 June 2012 cc332-340).

> I am also increasing the rate of the bank levy to 0.105% from next January, so that the additional corporation tax cuts do not benefit the banks, and so that our levy will in addition raise the £2.5 billion a year that we said it would.[133]

The Budget report estimated that the cut in corporation tax would cost £730m by 2013/14, whereas the rise in the bank levy would raise £420m in the same year.[134] In their forecasts the Office for Budget Responsibility noted that they expected a drop in receipts over the period 2011-2013 as "we now expect growth in bank balance sheets to be further constrained by regulations such as Basel III and the proposals from the Independent Commission on Banking." They went on to say that "the rise in the bank levy rate announced in Budget 2012 largely offsets these downward revisions from 2013-14 onwards."[135]

While reactions to the Budget focused on changes to personal taxation, there was some discussion of the Chancellor's cut in corporation tax – which was strongly welcomed by business.[136] By contrast there was relatively little mention of the rise in the levy; in a piece on the business measures in the Budget Jonathan Guthrie at the *Financial Times* noted the fact that the banking sector would not benefit from the rate cut, though he was not optimistic about the impact that the Government's fiscal measures could have on the wider economy:

> Mr Osborne singled out the banking sector as the bad kid that did not deserve a sweet. … [Meantime] … this Budget made nary a ripple in the markets. … The historic weakness of business has been to plan for an economic future unblemished by crises such as market crashes and wars. Now strategists have veered to the opposite extreme … Mr Osborne is driving skilfully in bad conditions. Are we nearly there yet? No chance.[137]

Provision to increase levy rates was made by s211 of the *Finance Act 2012*. This was debated by the Committee of the Whole House, when the Opposition moved an amendment, to require the Treasury to review the case for incorporating a tax on bank payroll into the levy. Speaking for the Opposition, Owen Smith argued that this would "generate significant revenues, which could be used to create youth jobs … and to create new affordable homes."[138] In his response Treasury Minister Mark Hoban said, "the rate increase introduced in the clause puts us back on track to ensure from 2013 … the levy will raise at least £2.5 billion." The Minister also confirmed that the Government would an operational review of the levy in 2013, and opposed the case for a payroll tax, arguing that other measures – such as the FSA's

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133 HC Deb 21 March 2012 cc802-3. The rates of the levy were now set to be 0.105% (full rate) and 0.0525% (half rate) from 1 January 2013 (HMRC, *Bank Levy: 2013 Rate Change*, March 2012).

134 *Budget 2012*, HC 1853, March 2012 p50 (Table 2.1 – items 7 & 8).

135 *Economic and fiscal outlook*, Cm 8303, March 2012 p102 (Table 4.8), para 4.89

136 "Growth fears mar 'bold move' delight" & "Lex Column: UK corporate taxes", *Financial Times*; "Surprise tax break will give UK firms lowest rate in G7", *Guardian*; "Corporation tax reduction throws down gauntlet to G7", *Times*; 22 March 2012

137 "Treats for the favoured and a sugar rush for bankers", *Financial Times*, 22 March 2012

138 HC Deb 18 April 2012 c397

remuneration code – had been far more effective in making bonus payments more closely related to performance.[139]

In his Autumn Statement on 5 December 2012 Mr Osborne another 1% reduction in the main rate of corporation tax, with an associated cut in the rates of the bank levy:

> I want Britain to have the most competitive business tax regime of any major economy in the world. I have already cut the main core rate of corporation tax from 28% to 24%, and it is set to fall further to 22% … I am today cutting the main corporation tax rate again by a further 1%. In America, the rate is 40%; in France, it is 33%; in Germany, it is 29%. From April 2014, the corporation tax rate in Britain will stand at 21%. That is the lowest rate of any major western economy … We will not pass the benefit of that reduced rate on to banks, and to ensure that we meet our revenue commitments, the bank levy rate will be increased to 0.130% next year. Making banks contribute more is part of our major reforms to the banking system.[140]

The cut in the main rate of corporation tax was estimated to cost £415m in 2014/15, rising to £875 by 2016/17. By comparison the increase in the bank levy was set to raise around £545m per year from 2014/15.[141] Draft legislation was published a few days after the Chancellor's statement.[142] There was little commentary on this change, though in a survey of the banking sector in the *Tax Journal*, the authors argued that one further impact on projected yields, beyond the cut in the corporation tax rate, would be the banks' shifting away from short-term loans:

> The twin policy goals of the Government in introducing the bank levy are to encourage banks to move to a less risky, longer-term funding and to ensure banks make a 'fair contribution' to the UK financial system … The twin policy goals … present a bit of a 'catch 22' situation which signals further rate changes ahead: rather ironically for a tax which is aimed at changing behaviour, the more the banks align their funding strategy with government policy by shifting short-term loans to long-term debt and equity, the lower the tax stake and the higher the bank levy rates will need to go …
>
> Even though the levy has been the bank levy has been introduced in order to achieve specific goals, and should arguably therefore be repealed once it has achieved those goals, it would be overly optimistic to imagine it is going anywhere. In the absence of a 'sunset clause' the most we have is a commitment by the government to review the policy in 2013. It is not yet clear what format that review will take, but both HMRC and the banking sector are already thinking ahead to it.[143]

In his 2013 Budget speech the Chancellor announced that from April 2015 the main rate of corporation tax would be set at 20%. As with previous reductions

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139 HC Deb 18 April 2012 c407. The amendment was defeated by 322 votes to 251.

140 HC Deb 5 December 2012 c881

141 *Autumn Statement 2012*, Cm 8480, December 2012 (Table 2.1 – items 8 & 34). As with earlier rate rises, the Treasury did not anticipate any significant behavioural impact depressing receipts from the rate rise (HMT, *Autumn Statement 2012 policy costings*, December 2012 p12).

142 HMRC, *Bank levy: 2013 rate change*, December 2012. See also, HC Deb 11 December 2012 cc16-18WS.

143 "Sector focus: the UK banking sector", *Tax Journal*, 9 November 2012

in the main rate, the bank levy would be increased, to offset any benefit accruing to the banking sector:

> We also set out to compete with the world in our headline rate of corporation tax. In Germany, the corporate tax rate is 29%; in France it is 33%; in the United States it is 40%. Here in Britain we have cut corporation tax from the 28% we inherited to 21% next year. But I want to go further. Today I want us to send a message to anyone who wants to invest and create jobs here that Britain is open for business, so in April 2015 we will reduce the main rate of corporation tax by another 1%. Britain will have a 20% rate of corporation tax, the lowest business tax of any major economy in the world. That is a tax cut for jobs and growth.
>
> We will have achieved in one Parliament, and in these difficult times, the largest reduction in the burden of corporation tax in our nation's history, and with it we will achieve major simplification of our business tax system. By merging the small company and main rates at 20p, we will abolish the complex marginal relief calculations between them and give Britain a single rate of corporation tax for the first time since 1973. As with previous reductions in the corporate tax rate, I do not intend to pass the benefit on to the banking sector, so I will offset the reduction by increasing the bank levy rate next year to 0.142%.[144]

The Budget report confirmed that the levy rate would be set at 0.142% from 1 January 2014, and that this increase is forecast to raise around £250m a year from 2015/16.[145] As with previous Budgets, there was little comment on the tweak to levy rates, though the *Financial Times* quoted Matthew Barling, a banking partner at PwC, saying, "[the levy] is a major cost for banks operating in the UK and is not a good advert for the City of London's competitiveness as a global financial centre."[146] The *Times* quoted Ian Gordon, at Investec, as saying, "whereas each and every reduction in tax should be welcomed, the claw-back through the bank levy falls unevenly – and quite inequitably – on HSBC, Barclays and Standard Chartered."[147]

In the debates following the Budget statement, Members did not discuss the levy in any detail, although, for the Opposition, Chris Leslie suggested that the Chancellor had "gone soft" on the levy, because levy receipts in the first two years of its operation had proved considerably less than initially forecast.[148]

Provision to increase levy rates for both 2013 and 2104 was included in the *Finance Bill 2013*, which was one of the parts of the Bill selected for debate by

144 HC Deb 20 March 2013 cc939-40

145 *Budget 2013*, HC 1033, March 2013 p65 (Table 2.1 – item 40). See also, HMRC, *Bank Levy 2014 rate change*, 23 March 2013

146 "Rate cut gives companies edge", *Financial Times*, 21 March 2013

147 "Banks face higher levy s bosses get big payouts", *Times*, 21 March 2013

148 HC Deb 25 March 2013 c1392. The 2011 Budget forecast levy receipts for 2011/12 and 2012/13 to be £1.9bn & £2.6bn respectively (*Budget 2011*, HC 836 March 2011 p92). As noted above, receipts for these years were £1.6bn (HMRC, *Tax receipts and National Insurance contributions for the UK*, October 2021).

the Committee of the Whole House, at the start of the Bill's Committee stage.[149]

On this occasion Mr Leslie reiterated his concern as to the apparent shortfall in receipts, noting that "all in all, the banks have paid £1.1 billion less than they were supposed to pay in the last financial year." In response the then Financial Secretary, Greg Clark, underlined the point that the most recent increases in rates would "cause the bank levy to yield not £2.5 billion in future, but £2.7 billion this year, and £2.9 billion for every year in the future. This extra revenue more than makes up for the shortfall in revenues experienced during the first two years."[150] One further amendment was made to the levy at the report stage of the Bill, when the Government introduced a provision to ensure that the exemption of high-quality liquid assets would not be subject to any legal challenge, following concerns that some banks were exploring options to have a wider range of assets qualify for relief.[151]

During 2013 the Government conducted two consultation exercises, first on the Code of Practice on Taxation for Banks, and second, on the practical operation of the bank levy.

In the first case, in the 2013 Budget the Government announced plans to legislate, to require HMRC to publish an annual report on the Code. This could "include the naming of any bank that HMRC considers not to be complying with the Code."[152] Further details were given in a consultation document published in May, which noted that, "although the Code is generally operating well, it lacks public transparency. There are also no obvious downsides for banks from not adopting the Code and no codified consequences for non-compliance with a bank's Code commitments." No proposals were made to change the Code itself; rather the consultation focused on:

- the governance process around determining non-compliance,
- the processes and criteria by which a decision to name a bank as being non-compliant will be made, and
- the nature of the report to be published by HMRC.[153]

In July 2013 the Government published a second consultation document, asking for views on the design of the levy, though, as this noted, "feedback received to date indicates that the bank levy is largely operating as intended and is fulfilling its policy objectives":

> This review is therefore focused on the following areas.

149 HC Deb 17 April 2013 cc368-402. These provisions are now ss202-3 of *FA2013*.

150 HC Deb 17 April 2013 c369, c402

151 New Clause 6 to the Bill which was agreed without a vote, after a short exchange of views (HC Deb 1 July 2013 cc 706-10).

152 *Budget 2013*, HC 1033 March 2013 para 2.219

153 HMRC, *Strengthening the Code of Practice on taxation for banks*, 31 May 2013 paras 1.6, 1.12. see also, "Analysis: recent developments on the banking code of practice", *Tax Journal*, 11 October 2013.

- The operation and compliance aspects of the levy and whether there are changes that can be made to simplify and reduce compliance costs.
- Ensuring the legislation can be applied fairly (given its twin objectives) to the bank levy population, which contains banks that have numerous differences in activities, location, structure and systems.
- Within the broad design framework, the operation of specific design features, and whether there is merit in making changes to these that would better align the levy with its objectives – particularly with regard to targeting riskier funding. Any changes here would have the potential to adjust the current levy burden faced by individual institutions.
- Ensuring that the bank levy remains aligned with the current regulatory regime and that proposed changes to the regulatory rules are taken into account in the bank levy design.
- Improving the understanding of revenues, taking into consideration the factors that drive balance sheets.[154]

One practitioner writing in the *Tax Journal* at this time suggested that the levy "is, in all likelihood, here to stay … [the levy] does not appear to have caused major banks to flee the UK [and] … it provides a useful (albeit, in the overall scheme of things, fairly modest) contribution to [reducing the structural deficit]."[155]

In his Autumn Statement on 5 December the Chancellor announced that from 1 January 2014 "the rate of the bank levy will rise to 0.156% and its base will be broadened in ways that we have consulted on." (The half rate applying to chargeable equity and long term chargeable liabilities would rise from 0.071% to 0.078%.[156]) Mr Osborne gave revised estimates for the levy's yield in future years: it would "raise £2.7bn in 2014/15 and £2.9bn each year from 2015/16. The country stood behind the banks in the crisis, and now it is right that they support the country in recovery."[157] Taken together these changes were forecast to raise £265m in 2014/15, rising to £535m by 2015/16.[158]

In the light of this announcement, one practitioner in the *Tax Journal* argued that the continued difficulties in raising the expected yield "should become a less in the problems of saddling a new tax aimed at managing behaviour with a fixed revenue target":

> The bank levy's aim was to encourage changes to banks' funding models, while also consistently raising £2.5bn. After three years, it is becoming apparent that a tax policy with these dual objectives is a policy with a fault line at its heart … The legislation was crafted so that taxpayers could reduce their chargeable liabilities by switching to a more equity capital or long-term funding over

154 HMT/HMRC, *Bank Levy Review 2013*, 4 July 2013 para 1.13-4

155 "Why the bank levy is 'here to stay'", *Tax Journal*, 19 July 2013

156 HMRC, *Bank levy 2014 rate change – tax information & impact note*, December 2013

157 HC Deb 5 December 2013 c1107

158 *Autumn Statement*, Cm 8747, December 2013 p78 (Table 2.1 – item 20); *Autumn Statement 2013: Policy Costings*, December 2013 pp15-16. It was estimated that by 2015/16 the higher rate would raise £260m, and the redesign of the charge £275m.

> short-term debt; by accepting more retail deposits; and/or by holding more high quality government securities. During the following three years, banks did all of these things. However … the Government had to deal with the implications of the £2.5bn revenue target. There was only one thing to do: keep increasing the rate.[159]

Further details of the proposed changes to the design of the levy were given in the Autumn Statement:

> Following a 2013 review into the operational efficiency of the Bank Levy, the government will introduce legislation to:
>
> - limit the protected deposit exclusion to amounts insured under a deposit protection scheme
> - treat all derivative contracts as short-term
> - restrict relief for a bank's High Quality Liquid Assets to the rate applicable to long term liabilities
> - align the Bank Levy definition of Tier One capital with the new Capital Requirements Directive from January 2014
> - exclude liabilities in respect of collateral that has been passed on to a central counterparty from January 2014
> - widen legislation-making powers within the Bank Levy from Royal Assent to ensure it can be kept in line with regulation.
>
> These changes will take effect from January 2015, unless stated otherwise.[160]

The Government also confirmed its plans to have HMRC publish an annual report on the Code of Practice on taxation for banks from 2015; the report would name those banks that had and had not adopted the Code, and HMRC would also be able to name any bank that in their opinion were not complying with the Code:

> Legislation will be introduced in Finance Bill 2014 to ensure that HMRC publishes an annual report on the operation of the Code. The report will list groups or entities which have unconditionally adopted the Code at the date of the report as well as those groups or entities which have not adopted the Code. In addition the report will name any groups or entities that HMRC considers has not complied with Code.
>
> The legislation provides that where HMRC considers a group or entity has not complied with the Code before naming a group or entity in an annual report HMRC must first commission a report from an independent reviewer on

159 "Comment: lessons from the bank levy", *Tax Journal*, 14 March 2014

160 *Autumn Statement 2013*, Cm 8747, December 2013 p91. See also, HMRC, Bank levy review, December 2013.

> whether the Code has been breached and whether the group or entity should be named in an annual report.[161]

Writing on these changes, one practitioner noted, "although the legislation enacting the 'naming and shaming' provisions is not expected to be passed until summer 2014, that legislation will apply to any breaches of the code that occur from 5 December 2013 (or, if later, from when the bank agrees to adhere to the code.)" He went on to suggest that if successful, "similar concepts may well be extended beyond the banking sector."[162]

The Budget 2014 confirmed that the Government would proceed with these changes.[163] The Budget report also announced the Government would consult on re-designing the tax:

> The government will consult on the merits of a new charging mechanism for the bank levy, where banks are allocated into different bands according to their chargeable equity and liabilities and then charged an amount set for that band, with the overall level of revenue raised from the sector unchanged. A consultation document will be published on 27 March, with any subsequent changes to the bank levy's design legislated at the report stage of Finance Bill 2014 and applying for chargeable periods commencing on or after 1 January 2015.[164]

In its consultation document the Government underlined their intention that any changes would be revenue-neutral:

> The Government believes that these overarching policy objectives remain appropriate and does not intend to change either the target level of revenue raised through the bank levy or the design of the underlying tax base, which was consulted on as part of a 2013 operational review …
>
> Instead, this consultation considers a revenue neutral change to the mechanism by which banks are charged under the levy, which would move away from the existing system of headline rates and towards a banding approach. Under this approach, banks would be allocated into different bands according to their chargeable balance sheet equity and liabilities, with each band then corresponding to a pre-set charge paid by all banks within that band.
>
> The consultation seeks views on the overall concept of banding, including the extent to which it would improve the predictability and sustainability of bank levy receipts and address some of the concerns that have been raised around its existing design. It then considers how a banding model would need to be designed in order to achieve these objectives, presenting illustrative options for how the bands and charges could initially be structured, how the bands

161 HMRC, *Code of Practice on taxation for banks*, December 2013. This change was not expected to have an Exchequer impact. See also, Richard Collier, "Intentions, Banks, Politics and the Law: The UK Code of Practice on Taxation for Banks", *British Tax Review*, No.4, 2014.

162 "The adviser Q&A: the Code of Practice on taxation for banks", *Tax Journal*, 13 December 2013. Draft legislation to effect these changes was published at this time.

163 *Budget 2014*, HC 1104, March 2014 para 2.122-4. No substantive changes were made to the draft legislation published in December (HMT, *Overview of tax legislation and rates*, March 2014 p17).

164 *Budget 2014*, HC 1104, March 2014 para 2.125. Details of the consultation exercise are on Gov.uk. Responses were invited up to 8 May 2014.

> and charges could be adjusted moving forward, and how the model's inevitable cliff-edge effects could be addressed.
>
> Additionally, the consultation sets out the key considerations in using the bank levy to meet the UK's obligations under the EU Bank Recovery and Resolution and Deposit Guarantee Scheme directives and asks whether there could be changes to the bank levy's design that would better enable its costs to be accrued for quarterly reporting purposes.[165]

In the coverage of the Budget there was little mention of these changes, though the question of how much the levy had raised continued to be controversial. Speaking for the Opposition during the second reading debate of the Finance Bill, Chris Leslie, argued that there had been a £1.8bn shortfall in receipts since the levy was introduced:

> The purpose of the bank levy, of course, was to allow the Government to take £2.5 billion every tax year. It was an unusual tax because they set the amount of revenue to be raised and the methodology revolved around that. In its first year, the levy brought in £1.8 billion, which was a significant shortfall. Things got worse the next year, because in 2012-13 it raised just £1.6 billion. My hon. Friends know the attitude Her Majesty's Revenue and Customs takes to our constituents if an amount of tax they are asked to pay is not forthcoming, but that is not the case when it comes to the banks. It has gone soft in collecting the amounts of money the levy was supposed to raise.
>
> We read in the small print of the Office for Budget Responsibility's report that accompanied the Budget that in 2013-14, for the third year running, the bank levy is projected to raise only £2.3 billion, which falls short yet again. The combined shortfall from the past three years is now a very significant £1.8 billion.[166]

Prior to the Budget the then Shadow Chancellor, Ed Balls, proposed the reintroduction of the bank payroll tax, as one of a number of tax rises to fund a 'jobs guarantee for young unemployed people' – a scheme to provide a paid-job for 6 months for the long-term unemployed.[167] The party was quoted as suggesting, "on a cautious estimate" that a one-off tax would raise £1.5-£2bn, though, in the light of Alistair Darling's assessment of the case for extending the tax discussed above, clearly any definite projections would be hedged with uncertainty.[168] In a piece on the jobs guarantee published at the time, Channel 4 FactCheck argued that unlike other policy costings that the Opposition had made, a £1.5-£2bn yield from a bonus tax "is not a figure endorsed by the House of Commons Library or other independent analysts."[169]

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165 HM Treasury, *A bank levy banding approach: consultation*, March 2014 p3

166 HC Deb 1 April 2014 c762

167 specifically under-24s who have been out of work for more than a year and adults aged 25 or over who have been claiming jobseeker's allowance for more than two years. For details see, "Balls targets bonuses and top property for £6bn tax raid", *Financial Times*, 11 March 2014 & "Ed Balls defies critics and defends jobs guarantee plan", *Guardian*, 11 March 2014

168 In a debate on bankers' bonuses in February the next year, Shabana Mahmood, Shadow Treasury Minister, said that in government the Labour Party would "repeat the tax on bankers' bonuses which we introduced in 2009, to raise £1.5 to £2bn" (HC Deb 25 February 2015 c373).

169 "Does Labour's youth jobs guarantee add up?", Channel 4, 10 March 2014

The House debated the provision in the *Finance Bill 2014* to set the bank levy rates for 2014 on 9 April.[170] Speaking for the Opposition, Cathy Jamieson moved a new clause, to require the Government to review the case for a bank payroll tax, and for the proceeds being used in the way the Shadow Chancellor had suggested. Ms Jamieson noted that "several of the big banks … proposed significantly higher bonuses for 2013 … I know that some of the banks claim that their overall bonus pool is coming down but for the ordinary person in the street the figures are more than they would ever hope to win in a lottery in their wildest dreams." She went on to say that the Opposition's job guarantee "would cost about £1.9bn":

> The cost would be met in the first year by the tax on bonuses and by the reduction in the rate of tax relief available to those earning more than £150,000 a year. Those measures should generate more than £2.5 billion, and the annual revenue generated by the changes to pensions tax relief would fund the jobs guarantee throughout the next Parliament.[171]

Ms Jamieson also raised several concerns over the operation of the bank levy which, in her view, made it eminently reasonable to have "a full and comprehensive review of all taxes levied on the banking sector":

> Let me say something about the problems with the levy as we see them. As I have said … the Government's levy lacks ambition. The argument is that the initial levy was set at a relatively low rate, both by international standards and when measured against the scale of the taxpayer subsidies received by the sector during the financial crisis and thereafter … One other problem with the levy is that its two objectives can be seen as a bit of a paradox or even somewhat contradictory.
>
> By setting the levy as a tax on bank liabilities in excess of £20 billion and charging a lower rate for more secure long-term liabilities, the Chancellor was actively encouraging the banks to reduce their exposure by moving towards more stable forms of funding … Was the Chancellor unable or unwilling to decide whether he wanted behavioural change or a targeted revenue sum? Was it possible to do both? Some evidence suggests that it was not, because it has not brought in the amount of revenue that he intended …
>
> Given the consistent failure of the levy to raise the projected amounts, it would appear not only that the Government have miscalculated its behavioural impact, but they have failed accurately to predict the impact on the banks of their cuts to corporation tax … The failure of the bank levy to bring in the expected revenue means that effectively, the banks have received a tax cut, despite what the Minister will doubtless claim to the contrary.[172]

In response Treasury Minister David Gauke argued that the Government's policy objectives for the levy remained appropriate:

> Bank levy receipts have fallen short of the targets to date, largely as a consequence of greater than anticipated deleveraging in the sector in response to regulation and the bank levy's behavioural incentives. However,

170 HC Deb 9 April 2014 cc329-358

171 *op.cit.* cc332-3, c337

172 *op.cit.* cc338-9, c341

> the Government have remained clear that the target for bank levy receipts is unchanged.
>
> The banking sector needs to make a fair contribution that appropriately reflects its historical costs and future risks to the UK taxpayer. That is why the rate of the bank levy has increased from 0.075% in 2011 to 0.142% in January 2014, and why the changes being made in clause 112, which were announced in the 2013 autumn statement, will further increase the rate to 0.156%, which will be treated as having applied from January 2014. Based on those changes, the independent Office for Budget Responsibility forecasts that the bank levy will raise £2.9 billion a year from 2015-16, more than £8 billion in total over the Parliament and close to £20 billion in total by 2018-19.[173]

Mr Gauke went on to argue that a formal review of the taxes paid by the banks was unnecessary, and that there was "no reason" for the Government to change its approach, in taxing banks' balance sheet equity and liabilities:

> The Government do not consider that there is much to be achieved by accepting [this proposal] … HMRC already publishes each year statistics on PAYE, the bank levy, corporation tax and bank payroll tax receipts from the banking sector, although they are not broken down by different groups of banks. The most recent publication—from August 2013—showed that the relevant tax receipts from the banking sector were £21.7 billion in 2012-13.
>
> In September 2010, the right hon. Member for Edinburgh South West (Mr Darling), the former Chancellor of the Exchequer, said [the bank payroll tax] … "will be a one-off thing because, frankly, the very people you are after here are very good at getting out of these things and…will find all sorts of imaginative ways of avoiding it in the future." An attempt to repeat that tax would be a mistake … [and] we see no reason to change [our] … approach.[174]

As mentioned above, the Government anticipated that any reforms arising from its consultation on the bank levy would be made by adding provisions at the report stage of the Finance Bill. On 26 June 2014 Treasury Minister, Andrea Leadsom, announced that the Government would *not* proceed with a banding approach, as responses had indicated that this would "create uncertainty over banks' charges, strengthen the incentives for activities to be relocated overseas and create arbitrary differences between banks' effective tax rates and the relevance of the levy's behavioural incentives.[175]

In the Coalition Government's last Budget in March 2015, Mr Osborne announced that the rates of the bank levy would be increased, though this was not combined with a cut in the main rate of corporation tax:

> Because we seek a truly national recovery, today I also ask our banking sector to contribute more. Financial services are one of Britain's most important and successful industries, employing people in every corner of the country … as our banking sector becomes more profitable again, I believe it can make a bigger

173 *op.cit.* c348

174 *op.cit.* c350. In the event the Opposition's new clause was negatived by 293 votes to 219.

175 HC Deb 26 June 2014 cc22-3WS.

> contribution to the repair of our public finances. I am today raising the rate of the bank levy to 0.21%. This will raise an additional £900 million a year.[176]

The new rates would apply from 1 April 2015, and, as the Chancellor noted, it was estimated that this would raise around £900m a year from 2016/17.[177] The measure did not attract much comment at the time, though Mr Osborne was asked about the future role of the levy when he appeared before the Treasury Select Committee to give evidence on the Budget, a few days later:

> **Q205 Mark Garnier**: … You have increased the bank levy. Originally it was there to help banks, if you like, help sort out the economy, having created quite a significant problem. There has been a little bit of accusation that you are using this now to raise general taxation. Why are you raising the bank levy? Is it in response to Opposition parties looking to impose a bonus tax, which is to all intents and purposes unenforceable because people would work out a way of getting around it? Is this a response to that bonus tax proposal?
>
> **Mr Osborne**: I've always been clear that the bank levy was designed to achieve two things. One was to make sure that we were bearing down on leverage and on wholesale funding and the like of balance sheets, but I also was explicit that the banks had to make a contribution to the consolidation. That is the reason why I feel, as the banks are becoming more profitable, they can make a further contribution. The international tax community, in the form of the IMF, have identified two suitable taxes—one is a bank levy and one is a financial activities tax. So the bank levy seemed an appropriate tool to use. I think it has been fairly effective. It is pretty straightforward. It raises the money for the Exchequer so we can spend it on our public services and the like.
>
> On the bonus tax, again I refer to what Alistair Darling has told us. He has told us that it is not possible to sustain a bonus tax because it leads to massive avoidance. His plan was only ever to have a one-year only bonus tax and he has been pretty scathing of his party's proposals in that regard.[178]

Provision to increase levy rates was made in the Finance Bill introduced after the Budget, and agreed prior to the Dissolution of the House.[179]

Finally it is worth noting that in his Autumn Statement on 3 December 2014, the Chancellor announced one further change to bank taxation, reflecting the long-term impact of the banking crisis:

> Under the rules we inherited, banks can offset all their losses from the financial crisis against tax on profits for years to come. Some banks would not be paying tax for 15 or 20 years, which is totally unacceptable. The banks got public support in the crisis and they should now support the public in the recovery. I am today limiting the amount of profit in established banks that can be offset by losses carried forward to 50%, and delaying relief on bad debts, which together will mean that banks contribute almost £4 billion more in tax over the

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176 HC Deb 18 March 2015 c773

177 HM Treasury, *Budget 2015 Policy Costings*, March 2015 p25

178 *Oral evidence: Budget 2015*, HC 1082, 24 March 2015 pp8-9. See also, "Osborne says bank levy to remain part of tax system", *Financial Times*, 25 March 2015

179 HC Deb 25 March 2015 cc1437-1534. The provision was not one of the small number selected for debate. It now forms s76 of *FA(No2)2015*.

> next five years. We will also put in place internationally recognised measures on hybrids and the reporting of tax by country.[180]

In their assessment of the Treasury's policy costings, the Office for Budget Responsibility considered that the uncertainty over this estimate was "very high", and it was based on "uncertain assumptions about the profitability of banks over the scorecard period."[181] In their assessment of tax measures in the Autumn Statement, the Treasury Committee highlighted that the yield from this measure was uncertain, and that it could be considered retrospective, as it would apply to losses accrued up to 1 April 2015:

> Loss relief is an important element of tax planning for all firms across all parts of the economy. The Committee has previously highlighted the importance of certainty in the tax system in its 2011 Report, Principles of Tax Policy. Apparently lucrative tax raising measures against unpopular sectors of the economy, while attractive to governments, carry the risk of undermining the principle of certainty in the tax system. Uncertainty may well reduce the yield.[182]

In the March 2015 Budget the Government confirmed it would proceed with this measure, though in the light of consultation it would "be making a change to the measure's targeted anti-avoidance rule and introducing a £25 million allowance for affected building societies."[183] It also stated that it would consult on legislation to make banks' customer compensation expenses non-deductible for corporation tax purposes.[184]

In its response to the Treasury Committee, the Government acknowledged that the revenue estimates were relative uncertain, but argued that restricting the tax deductibility of losses in this way was a "specific response to a particular combination of circumstances":

> Where the OBR is content with the costing, it will certify the costing as a central estimate of the impact of the measure on the public finances. As a result, any uncertainty lies on both sides: the measure could raise or cost more or less than expected. The Treasury will continue to work with HMRC and the OBR to evaluate anti-avoidance measures as they become active ...
>
> The government set out its approach to tax policy making in December 2010 and promotes certainty and stability throughout this process where possible. Loss relief restriction was a specific response to a particular combination of circumstances: losses accrued as the result of the financial crisis, misconduct

180 HC Deb 3 December 2014 c311. For more details see, HMRC, *Corporation tax: bank loss-relief restriction*, December 2014. See also, "Analysis: draft FB2015 – loss restrictions on banks", *Tax Journal*, 30 January 2015.

181 OBR, *Economic & Fiscal Outlook*, Cm 8966, December 2014 p211

182 *Autumn Statement 2014*, HC 870 of 2014-15, 13 February 2015 para 117

183 *Budget 2015*, HC 1093, March 2015 para 2.138. For more details see, HMRC, *Restriction on brought forward reliefs in the UK banking sector - technical note*, March 2015

184 *Budget 2015*, HC 1093, March 2015 para 2.132. The report put the annual yield from this at £150m in 2015/16, rising to £260m the next year, before falling each year to reach £150m by 2019/20 (Table 2.1 – item 24).

> and mis-selling scandals being used to reduce future corporation tax payments.
>
> To maximise the potential yield from the measure it was not possible to consult with the sector prior to making the announcement and an anti-forestalling provision was required to reduce the scope for banks to circumnavigate the restriction. Draft legislation was published on the day of the announcement; we have subsequently consulted on this and incorporated certain recommendations.[185]

At the time the Government updated its estimates of the total yield of this measure over 2015/16 to 2019/20 from around £3.5bn to about £4bn.[186]

185 *Sixth special report*, HC 1151 of 2014-15, 27 March 2015 p8

186 *Autumn Statement 2014*, Cm 8961, December 2014 p65 (Table 2.1 – item 34); *Budget 2015*, HC 1093, March 2015 p66 (Table 2.2 – item t)

4 The Conservative Government's approach

4.1 Discussion of bank taxation & the 2015 Election

In the run up to the 2015 General Election, the Institute for Fiscal Studies published a series of papers, including a review of the Coalition Government's approach to corporate taxation. In this the authors argued that the Government's decision to set a revenue target for the levy had been flawed, and that the new cap on offsetting losses could raise concerns over the direction of future policy:

> The coalition government implemented two policies targeted at banks. First, in January 2011, the bank levy – a tax on certain equity and liabilities of banks and building societies – was introduced with a stated aim to 'ensure that the banking sector makes a fair contribution … reflecting the risks it poses to the financial system and the wider economy'.[187]
>
> The government's original goal was to raise at least £2.5 billion each year. In a recent consultation on the bank levy, the government announced that it views £2.9 billion each year as a reasonable revenue target.[188] Part of the rationale for the increase in the revenue target is to reduce the benefits that banks have received from cuts to the corporation tax rate.
>
> Increases to the bank levy rate have been announced on no fewer than six occasions in the last four years. The 2013–14 bank levy receipts were £2.3 billion. The December 2014 OBR forecast suggests that the levy will raise £2.7 billion in 2014–15 and £2.9 billion in 2015–16. While there may be a good rationale for having a tax like the bank levy, changing it so frequently introduces potentially damaging uncertainty into the tax system. Furthermore, setting a revenue target for a tax, and adjusting the rate to meet that target, is not a good way to make tax policy. It can imply taxing more elastic behaviours (those that change more in response to a tax change) more, which increases the distortions brought about by the tax.
>
> Second, effective from April 2015, there will be a 50% cap on the proportion of taxable profits that banks can offset each year using losses that were accumulated before 2015. This works to bring government revenues forward by delaying when banks are able to offset losses against taxable profits. Because it applies to activities that have already occurred, it is unlikely to distort investment decisions. However, it does affect banks' cash flows and may raise

187 HM Revenue & Customs, *Bank levy 2014 rate change*, December 2013

188 HM Treasury, *A Bank Levy Banding Approach: Consultation*, 2014

> concerns over future policy, thereby increasing uncertainty and potentially discouraging investment.[189]

In the Election campaign, reforms to bank taxation did not feature in the Conservative Party's manifesto.[190] By contrast the Labour Party reiterated its pledge to use a bank bonus tax to fund its 'Compulsory Jobs Guarantee', and proposed a rise in the bank levy to raise a further £800m, so as to extend provision of free childcare.[191] In their assessment of the parties' tax and spending plans, the IFS suggested that there were some drawbacks to having a second bonus tax, not least the question of its potential yield:

> [The Party] estimates that this would raise £1.5–2 billion, though given that the size of banks' bonus pools has fallen substantially – halved since 2009, according to the British Bankers' Association– this revenue estimate does not look cautious.
>
> There may be arguments for heavier taxation of the financial sector and those working within it. It is harder to see why bonuses should be taxed more heavily than fixed pay: why someone receiving a bonus should be taxed more heavily than someone receiving the same total remuneration via a higher fixed salary instead. If banks responded by reducing bonuses and increasing fixed pay instead, it would make the banks' financial position more rather than less risky by reducing their scope to reduce remuneration costs in adverse circumstances.
>
> A temporary tax opens up the possibility of avoiding the tax by hanging the timing of bonuses (paying bigger bonuses the next year instead, for example), though new EU limits on the size of bankers' bonuses would limit the scope for this. But if the policy is believed to be one-off, it should have less effect on the real behaviour either of banks or of bankers. As a permanent policy, the downsides of the tax might be more serious. The fact that this would be the second time such a tax had been levied, however, might lead people to doubt whether it would really be 'one-off'.[192]

The authors went on to question whether "changing [the rates of the bank levy] every year and continuing to try to raise ever-more revenue from the bank levy is economically sensible":

> Any future government should be clear about its reasons for having a bank levy, and set (and maintain) the rate that best meets those aims. On the goal of reducing risk in the financial system, the base of the bank levy is reasonably well designed to encourage banks to use more equity capital and borrow less, thereby reducing the risks associated with high leverage. But the levy must be considered alongside regulations over capital requirements, which allow banks that have more equity capital to hold riskier assets.

189 Helen Miller & Thomas Pope, *Corporation Tax Changes and Challenges*, IFS Briefing Note BN163, February 2015 p8

190 The manifesto simply stated, "we will keep the bank levy in place and restrict established banks' ability to pay less tax by offsetting their profits against past losses" (*The Conservative Party Manifesto*, April 2015 p9).

191 *Britain can be better: the Labour Party Manifesto 2015*, April 2015 p24, p44

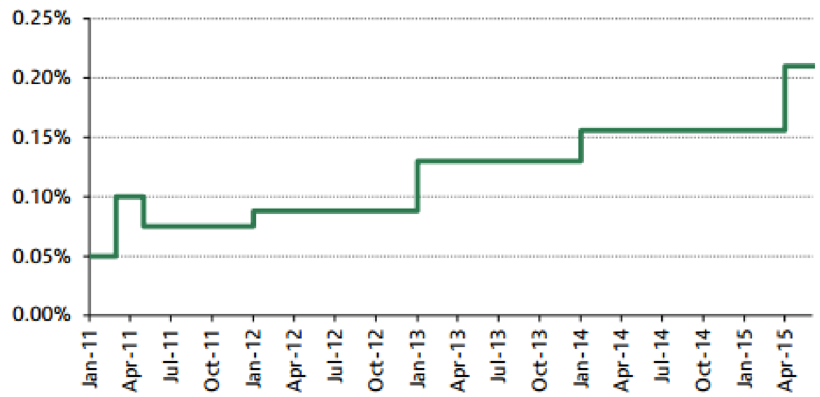
192 *Taxes and Benefits: The Parties' Plans*, IFS Briefing Note BN172, April 2015 pp37-8

A study of the UK's bank levy and similar levies in other EU countries found that banks did use more equity in response to the levies, but that for riskier banks – those that had little initial equity (and were therefore more likely to find the regulations a constraint) – this was accompanied by a move to hold riskier assets: reduced funding risk but increased portfolio risk. The study concluded that 'while the levies have reduced the total risk of relatively safe banks, they have done nothing to curb the risk of relatively risky banks, which presumably pose the greatest threat to financial stability.'[193]

If the objective is to discourage excessive risk-taking, the tax rate should be set in conjunction with regulatory capital requirements to provide the appropriate spur to reduce risk, and there is no obvious reason that it should rise or fall over time. Other objectives might imply different designs for a tax. If the goal is simply to raise more revenue from the banking sector rather than to correct a specific problem in the market, then policymakers should aim for a tax with as little effect on the market as possible, and behaviour changes induced by a higher bank levy should be regarded as an undesirable distortion.

Labour seem to be continuing the coalition's approach of setting a revenue target for the tax and adjusting the rate to try to meet it. That is not a good way to make tax policy. It can imply levying higher taxes on activities that are more responsive to tax – the opposite of what policymakers should aim for, all else equal. For example, if a tax rise reduces the taxed activity more than expected, that implies that the tax distorts behaviour more than expected and therefore that the optimal tax rate is lower – yet a fixed revenue target would instead require a further increase in the tax rate.

Figure 3.4. The bank levy rate over time



Note: This figure shows the actual bank levy rate over time --- some announced changes were never implemented because a further increase was announced before the change took effect. The temporarily higher (0.1%) rate in March and April 2011 was intended to bring the effective rate for 2011 as a whole to 0.75%.

Whatever tax rate is chosen, stability is important. Since 2011, increases in the bank levy rate have been announced eight times. While there may be a good rationale for having a tax like the bank levy, changing it so frequently introduces potentially damaging uncertainty into the tax system. Figure 3.4 illustrates the many changes to the bank levy rate that we have already seen –

193 M. P. Devereux, N. Johannesen and J. Vella, *Can taxes tame the banks? Evidence from European bank levies*, Oxford University Centre for Business Taxation, Working Paper WP13/25, 2013

> and note that this ignores instances where a future bank levy rate has been specified and then changed before implementation. Yet another proposed increase, this time from the Labour Party, adds to the uncertainty and reinforces the damaging impression that further increases are to be expected on an arbitrary basis.[194]

In their manifesto the Liberal Democrats announced that if in government the Party would "continue the banking levy and introduce a time-limited supplementary corporation tax charge on the banking sector to ensure it continues to make a fair contribution to fiscal consolidation."[195] For its part the IFS raised concerns over how banks might react to the risk of an extra tax charge that only applied for a limited period:

> The Liberal Democrats propose to increase the rate of corporation tax for banks from 20% to 28% in 2016–17 and 2017–18. They say that HM Treasury estimates that this would raise £1 billion in each of those years. This would be the latest in a series of additional taxes on banks' activities since 2010, including a one-off bonus tax in 2010 …, a bank levy since 2011 … and, from 2015, a cap on the proportion of taxable profits that banks can offset each year against losses accumulated before 2015. It is not clear why we would want to have all of these.
>
> There are obviously many different taxes that could be imposed if the desire is simply to raise revenue from the financial sector. The question is what the more specific goal is: for example, to recoup the cost of past bail-outs, to charge banks for the implicit guarantees that the government is providing to them now, to discourage excessive risk-taking in future, or to offset the distortions caused by the exemption of financial services from VAT. Taxing a percentage of banks' profits in 2016/17 and 2017/18 is poorly targeted at any of those.
>
> The additional tax would provide an incentive for firms to minimise their UK taxable profits for the period of the charge. They could achieve this by, amongst other things, trying to alter the timing at which taxable profits accrue (for example, avoiding realising capital gains on assets during that two-year period, or paying off loans during the period) or by undertaking activities (such as capital investment or advertising) that incur tax-deductible costs during the high-tax period and generate income in later, lower-tax periods. For banks that are part of multinational groups, shifting activities, and possibly profits, outside the UK may provide additional scope to mitigate the tax.
>
> An upside of having a temporary tax is that, while it may generate timing responses, banks are less likely to make major changes to their real activities for the sake of saving tax for a short period.[196]

[194] IFS Briefing Note BN172, April 2015 p8, pp41-43
[195] *Manifesto 2015: Opportunity for Everyone*, April 2015 p27
[196] IFS Briefing Note BN172, April 2015 pp55-6

4.2 Summer 2015 Budget: new bank surcharge and cut in levy rates

Following the 2015 General Election, the Conservative Government presented its first Budget on 8 July 2015. Some weeks before the Budget, writing in the *Financial Times*, Patrick Jenkins made the case that the bank levy in its current form was 'unsustainable' and 'unfair': "banks cannot be vilified forever, if they are to sustain Britain's economic recovery … [moreover] HSBC … pays a third of the levy, despite having the bulk of its balance sheet overseas and having received no direct government support in the crisis." The author recommended removing foreign banks and UK banks' foreign operations from the scope of the levy, while extending it to other financial institutions, such as investment businesses.[197] The paper has also reported concerns that international banks - HSBC, Standard Chartered – might relocate to avoid paying the levy, particularly given the Coalition Government's record in regularly increasing levy rates.[198]

In his Budget speech the Chancellor, Mr Osborne, announced two changes to bank taxation:

> Banks make a key contribution to our economy, but they also need to make a fair contribution. It is important that they help pay down the debts built up during the banking crisis, but equally important that they go on creating jobs, not just in London but in Edinburgh, Leeds, Birmingham, Bournemouth and across the country …
>
> Our bank levy was introduced to raise revenue and increase the stability of balance sheets, and it has worked, but now it risks doing harm unless we change it. So I will, over the next six years, gradually reduce the bank levy rate, and after that make sure it no longer applies to worldwide balance sheets. But to maintain a fair contribution from the banks, I will introduce a new 8% surcharge on bank profits from 1 January next year.
>
> By getting this balance right, it means we will actually raise more money from the banks this Parliament, but at the same time make our country a more competitive place to do business.[199]

The Budget report set out the Government's proposals in detail:

> **Banking tax reform**
>
> **1.200** While the government considers that banks and building societies should make an additional contribution to reflect their unique risks, it recognises the need to balance this with considerations around UK competitiveness and banks' ability to support the broader economy.

197 "Bank levy is ripe for reform as lenders cannot be vilified forever", *Financial Times*, 11 May 2015
198 "More to HSBC's domicile talk than risk of UK leaving Europe", *Financial Times*, 26 April 2015
199 HC Deb 8 July 2015 c326

1.201 This Budget therefore sets out a long-term roadmap for the taxation of banks, designed to maintain this balance and take account of the very significant improvements in banking sector regulation and underlying profitability since the bank levy was first introduced. This involves three steps:

- the introduction of a new tax on banking sector profit from 1 January 2016, set at a permanent rate of 8%
- a phased reduction of the bank levy rate, from the existing rate of 0.21% to 0.18% from January 2016, 0.17% from January 2017, 0.16% from January 2018, 0.15% from January 2019, 0.14% from January 2020 and 0.10% from January 2021
- a change in the bank levy's scope from 1 January 2021, meaning that UK headquartered banks are levied on their UK balance sheet liabilities

1.202 This plan is forecast to increase banks' additional contribution by around £2 billion across the forecast period, helping to ensure banks make a fair contribution. However, it also sets a path towards a more competitive and sustainable model for raising revenue from the banking sector over the longer-term, which is a 26% rate of tax on profit – the lowest among G7 nations – and a 0.1% levy on UK balance sheet liabilities.

1.203 This means that banks' contributions will be increasingly aligned with profit and capital accumulation, reducing the risk of tax constraining lending or influencing banks' decisions on the location of internationally mobile activities. It also means that banks' contributions will be increasingly linked to activities within the UK, helping to reduce the impact of tax on the competitiveness of UK banks' overseas operations and helping to reflect the ongoing impact of regulatory reform and resolution planning in reducing the risk of these operations to the UK economy.

1.204 Finally, by allowing tax receipts to respond naturally to changes in banks' balance sheets and profitability, these changes will introduce stability into the banking tax regime and ensure that banks can incorporate tax into their business plans with greater certainty. This is reinforced by the government's decision to legislate the bank levy rate, out to and including 2020-21, in the upcoming Finance Bill.

1.205 As part of this banking tax roadmap, this Budget also announces that relief will be provided against the UK bank levy for payments made to the Eurozone Resolution Fund, consistent with the government's general policy on avoiding double imposition. Affected banks will be able to claim relief from 1 January 2016.

1.206 Companies are currently entitled to deduct the costs of compensation payments in calculating their profits liable for Corporation Tax. As announced at Budget 2015, the government is legislating to make compensation payments paid by banks in relation to widespread misconduct in the sector non-deductible for Corporation Tax purposes, effective from 8 July 2015. This is forecast to increase bank's Corporation Tax payments by around £1 billion over the next 6 years.[200]

[200] *Summer Budget 2015*, HC 264, July 2015 pp46-7

The Budget report also underlined that the new tax surcharge would "apply to banks' corporation tax profit before the use of any existing carried-forward losses." In addition, the tax would **not apply** to "the first £25m of profit within a group."[201] Further details were given in two tax information notes on the new bank surcharge, and the phased reduction in the levy, published alongside the Budget report.

Annual receipts from these two measures are estimated to peak in 2017/18 at £555m, before falling each year to reach £105m by 2020/21.[202] The OBR's Economic & Fiscal Outlook gave some details of the estimated Exchequer impact of each measure:

> **4.41** The Budget announced the introduction of a new surcharge tax on the profits of banking groups arising after 1 January 2016 … This measure is expected to increase receipts by around £1.2 billion a year from 2017-18 onwards. With the reductions in the bank levy staggered between 2016 and 2021, the reduction in the bank levy reaches £1.2 billion by 2020-21. …
>
> **4.66** Bank levy receipts are expected to fall from £3.7 billion in 2015-16 to £2.2 billion in 202021. This mainly reflects the graduated cuts in the bank levy rate from 0.21 per cent to 0.1 per cent by 2021 announced in this Budget …
>
> **4.67** Receipts from the bank levy have been difficult to forecast since its introduction in January 2011. The tax base – specific types of bank liability – has fallen away more quickly than expected. In light of recent announcements from some UK banks, we have maintained our assumption that banks will continue to shrink their balance sheets in the three years to also allowed for an increased level of double taxation relief, resulting from the rise in bank levies in a number of countries in the Euro area. This reduces bank levy receipts by around £250 million a year from 2016-17.[203]

Following the Budget the Institute for Fiscal Studies published some analysis, modelling the impact of Budget changes for individuals and households. The reform to bank taxation was discussed in Stuart Adam's presentation on the Budget's tax changes, where Mr Adam raised the question of the rationale for the 8% supplementary rate:

> **What is the rationale for a higher corporation tax rate for banks?**
>
> - Bank levy designed to discourage risky leverage (with mixed success)
> - But corporation tax just discourages declaring UK profits
> - Future profits not a good proxy for cost of past bail-outs, future risk posed, implicit insurance provided …
> - Maybe profits less responsive (e.g. internationally mobile) than profits of other companies?

201 *Summer Budget 2015*, HC264, July 2015 para 2.126

202 *Budget 2015*, HC264, July 2015 p73 (Table 2.1 – item 17). See also, HM Treasury, *Summer 2015 Budget Policy Costings*, July 2015 p16

203 Cm 9088, July 2015 pp101-2, pp106-7

He also noted that the proposed change to the levy's scope from 2021 represented a "significant giveaway [with] a large slice to HSBC."[204]

One commentator writing in the *Tax Journal* suggested that the policy was "media driven and the result of a political compromise … it's hard to quibble about restrictions on the deductibility of compensation payments … but it's also hard to square the introduction of a new bank-specific surcharge with the rhetoric around Britain being open for business." The authors noted the particular concerns of challenger banks: "they won't derive any benefit from the bank levy reduction given their size, but may well have profits above the £25m surcharge allowance. No wonder they are imploring the Chancellor to raise the allowance to £200m."[205]

This issue was raised during the evidence sessions the Treasury Committee held on the Budget. When Paul Johnson, director of the IFS gave evidence, George Kerevan asked what their assessment of the reforms had been:

> **Q84 George Kerevan**: I am interested in looking at your preliminary assessment of the impact of the shift away from the bank levy to a charge on bank profits. Presumably, given that the tax base is going to shift, it will have some impact on who pays and who pays what. I am particularly interested if new banks are brought into the tax, particularly the mutual building societies who are using their profits for capital rebuilding. Have you had a look at that in a preliminary way? What might the impact be?
>
> **Paul Johnson**: We have not looked at that particularly. I think there are two or three things to say. One is that, as I understand it, the increase in the corporation tax rate happens quite a lot before the full reduction in the bank levy, which is I think promised not to reach its minimum until after the next election, so there is an issue of timing there. Secondly, the bank levy was in a sense well targeted at risk capital. The issue with it was that it was continually raised as behaviour was changed and because it had a particular base, which was worldwide; it hit a small number of banks very hard. The increase in the corporation tax for all banks will spread that significantly more.
>
> My understanding is that the share price of banks following the announcement, some went up and some went down, and that is probably telling you quite a lot about who is winning and who is losing from this change. My expectation would be that this would reduce the capacity of some of those banks who have additional tax to do some lending at some point into the future, but quantifying any of that is certainly not within our expertise.[206]

When Mr Osborne gave evidence to the Committee, Mark Garnier asked the Chancellor whether reducing the levy while introducing the new charge on bank profits would not disadvantage challenger banks:

> **Q223 Mark Garnier**: … The bank levy is on liabilities of over £20 billion and that affects around 30 banks in the UK, whereas the surcharge is on profits of more than £25 million and that affects more like 200 banks. It does not affect those nascent challenger banks that have not yet got to profit, which are still

[204] Stuart Adam, Tax Measures, *IFS Summer post-Budget briefing*, 9 July 2015 (slide 12)
[205] "Summer 2015 Budget: Bank tax measures", *Tax Journal*, 31 July 2015
[206] *Oral Evidence: Summer Budget 2015*, HC 315, 15 July 2015 p31

> coming through, but it is to a certain extent going to limit the ability of those smaller banks to be able to grow in the early stages.
>
> **Mr Osborne**: They will still have … one of the lowest corporate tax rates in the western world, so this will still remain a very competitive place to do banking. On top of that, there are lots of other things we are doing to encourage competitor banks: reforming the payment system, breaking up the monopolies that exist there; making sure that our regulators are speedier at giving banking licences to those who pass the checks, and the like.[207]

Mr Kerevan went on to ask about the impact of the reforms on mutual building societies:

> **Q226 George Kerevan**: … The shift to the bank surcharge, profit surcharge, sweeps into the tax net the challenger banks, but particularly the mutual building societies, who I think are a special case. Can you see any implications for the operations of the mutual building societies with this?
>
> **Mr Osborne**: None has been brought to my attention. In other words, of course tax increases are not welcome by people, but I think we have the balance right when it comes to banking taxation, and there is a threshold, which means that the smallest mutuals and building societies would be excluded from this tax …
>
> **Q228 George Kerevan**: … You can see no difference in how you approach applying the surcharge to mutuals and profit making private concerns?
>
> **Mr Osborne**: No, I think you have to tax banking institutions as banking institutions. The regulatory regime makes a distinction in part between mutuals, and we have done more to support mutuals, credit unions; there is a whole piece of Treasury work underway on that. But no, I do not feel we can draw a distinction. After all, there are some mutuals that are very large, in size at least similar to big banks.[208]

The Treasury Committee did not publish a report on the Budget though the *Financial Times* reported concerns from Committee members and Andrew Tyrie, the Committee Chair, that challenger banks and building societies would have to pay the new surcharge.[209] Commenting on this issue, the paper's business editor, Jonathan Guthrie, suggested that any revision to the Government's plans was unlikely: "if Ozzie exempts building societies, he ought to give the same break to challenger banks and perhaps then big banks that needed no bailouts. So forget it."[210]

Subsequently the Chair raised these concerns in a letter to Andrew Bailey, Deputy Governor for Prudential Regulation at the Bank of England.[211] In his reply Mr Bailey noted that the Bank could not comment on specific tax

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207 *Oral Evidence: Summer 2015 Budget*, HC 313, 21 July 2015 p24

208 *op.cit.* pp25-6

209 "Osborne urged to reconsider building society tax", *Financial Times*, 20 August 2015

210 "Lombard: Not a very super tax", *Financial Times*, 20 August 2015. That noted, Mr Guthrie's piece was hardly a ringing endorsement, as he described both taxes as "dumb" as they applied "only to financial institutions, on the judgemental and inaccurate basis that they caused the crisis."

211 *Letter from Treasury Chair to Andrew Bailey on 'challenger banks'*, 7 October 2015

measures, but he did give a response to the question of what impact the surcharge might have on competition in the industry:

> You asked whether, in the PRA's view, the new corporation tax surcharge makes the retail banking sector more or less open to competition from new entrants.
>
> It is too early to point to consequences since the new tax arrangements will not apply until 1 January 2016. As regards your specific concern on new entrants, our understanding is that the tax will only apply to firms with profits in excess of £25m, and therefore new entrants in the start-up and early growth phases will not be materially impacted and some small banks will not be impacted at all. However, we expect the surcharge to apply to larger challenger banks.[212]

Provision to reduce the rates of the bank levy over the period 2016-21, and introduce the new bank surcharge, were included in the Finance Bill 2015 published after the Budget.[213]

When the Bill received a second reading on 21 July, George Kerevan asked the then Financial Secretary, David Gauke, about the impact of this reform on both mutuals and challenger banks:

> **George Kerevan**: In the shift to the new tax on banks, the Government are sweeping in mutual banks, building societies and the smaller challenger banks. That creates problems both in capital accumulation for the mutuals and in the ability of the new challenger banks effectively to gain capital to take on the larger banks. Is that an accident, or has some decision been taken to penalise those organisations?
>
> **Mr Gauke**: The first point I have to make is that banks with the smallest profits do not pay the surcharge. There is a minimum level to protect the very smallest banks. The bank levy that was introduced early in the previous Parliament reflected some of the issues that existed at that time. It was designed in part to encourage a different type of behaviour that would reduce risks. Regulatory changes have rather addressed that particular point.
>
> The move to a surcharge—a higher level of corporation tax—is sensible and timely given some of the changes that have been made. It is not possible in those circumstances to carve out those institutions that we like and dislike beyond putting in that de minimis level. That was a sensible approach to take.[214]

Speaking for the Opposition, Shabana Mahmood argued that the Government should give more details as the likely impact "that these measures will have on the diversity of the financial sector, including any disproportionate impact on building societies":

> Challenger banks are important for the overall health of the financial sector, because we need them to challenge the dominance of the big four or five banks. The Government will say, rightly, that the £25 million threshold is partly designed to prevent too much of the impact from being felt by challenger

212 *Letter from Andrew Bailey to Treasury Chair on corporation tax surcharge*, 16 November 2015

213 They now form ss16-17 of the *Finance (No.2) Act 2015*.

214 HC Deb 21 July 2015 c1390

> banks. Nevertheless … a lot of the commentary since publication of the proposals has focused on the genuine concerns of challenger banks, which are worried that despite the £25 million threshold, they will still be disproportionately affected, with a significant impact on consumer choice as well …
>
> There is serious concern about the impact that the 8% surcharge will have on building societies. Of the six main building societies—Nationwide, Yorkshire, Coventry, Skipton, Leeds and Principality—only Nationwide currently pays the bank levy.
>
> Based on the most up-to-date profit figures from 2014-15, it is estimated that the building societies will pay about £126 million a year through the corporation tax surcharge, equating to about £630 million up to 2020. The building societies point out that the primary way in which they build their capital is through retained profit, so a tax on profit has a disproportionate effect on them. Moreover, they do not have shareholders, unlike public limited companies, so this is, in effect, a tax on the customers who own them—retail savers and mortgage borrowers. It will be important for the Government to explain their thinking on building societies and what analysis there is of how these changes will play out for them in practice.[215]

In turn Roger Mullin (SNP) cited the views of the British Banking Association that the new surcharge would have a significant impact on lending by societies and smaller banks:

> The scope of the changes now captures both challenger banks and many building societies whose practices are very different from those of the big banks. Challenger banks already face additional hurdles compared with the big banks, and as the British Bankers Association has pointed out: "The surcharge's disproportionate effect on smaller and challenger banks was evidenced by the resulting fall in their share prices following the announcement, in some instances of over 10%."
>
> Of more concern to me and my colleagues is that the BBA has estimated that: "Our preliminary analysis based on modest growth projections across the sector suggests that the contraction in lending could be around £10 billion over five years".[216]

In turn these provisions were debated, and agreed, without amendment, at the Committee stage of the Bill on 8 September.[217] Speaking for the Opposition on this occasion Alison McGovern mentioned the anticipated change to the levy after 2020 ….

> To make up for the lost revenue from the levy, the Government are introducing a new surcharge on banks' profits, which is forecast to raise about £1.2 billion every year across the Parliament. When combined with the gradual decline in revenue from the bank levy, the result is a projected increase in revenue of about £2 billion across the Parliament. Clearly, this increase is welcome in the short term, but I have some questions about its sustainability over the long term. The Government's revenue costings for the banking sector do not take into account the planned cuts in the corporation tax rate, so will the Minister

215 HC Deb 21 July 2015 c1399-1400

216 *op.cit.* c1408 See also, BBA press notice, *Banks pay additional £40 billion in taxes*, 14 July 2015

217 HC Deb 8 September 2015 cc355-78

> inform the House precisely how much this cut will be worth to the banking sector over the Parliament?
>
> The bigger issue, though, is what happens after 2020. The Government have signalled their intention to reduce the scope of the bank levy from 2021 so that it applies only to UK balance sheets, as the Minister said. This would greatly reduce the revenue that the levy brings in, especially from big global banks. Will she please set out the rationale behind this decision and explain what effect this change would have on revenue from the banking sector further into the future? Are the Government not simply storing up problems in order to appease big global banks?

… before raising these concerns about the impact on competition in the industry:

> Our main objection to the Government's new policy is the effect on competition in the banking sector. I am sure there is agreement across the whole House that a competitive banking sector is vital to the long-term health of our economy—the City Minister has been touring the country praising new challenger banks in recent weeks, and well they deserve that praise—but the truth is that the changes in clauses 16 and 17 will directly harm small challenger banks and building societies, which need to grow to provide competition to the bigger players.
>
> The big banks are compensated for the new surcharge by the fall in the levy, whereas the small banks that did not pay the levy are simply smacked with a new tax. The Government are effectively spreading the taxation over the whole banking sector, reversing the previous position that only the biggest and riskiest banks should pay more. The reality is that the people worst affected by these measures are exactly the people the Government claim they are trying to help. The situation is particularly damaging when it comes to mutuals, because their main way of raising capital to expand or for new lending is through retained profits. They cannot simply sell shares, as other banks can—that is what it means to be a mutual.[218]

For the SNP Roger Mullin also raised concerns about the impact on smaller banks, suggesting that "it is hard to find any analyst who sees this as helpful for competition, diversity or entry."[219]

Mark Garnier MP argued that this decision to reform bank taxation was the right one, particularly in light of the incentives that the levy created for major banks to relocate outside the UK:

> The intention [behind the introduction of the levy] was to raise enough money from the levy to make up the shortfall that would follow from getting rid of the bonus tax, which was around £2.1 billion to £2.2 billion. The levy … started out at nine basis points, rising on nine occasions to 25 basis points. That resulted from the reduction of balance sheets and from the slight change in the shape of the deposits profile—moving away from the deposits profile that would attract the levy.

218 *op.cit.* cc358-9

219 *op.cit.* c365

> It is worth bearing in mind what Douglas Flint said when he came before the Treasury Select Committee in January 2011. I asked him for his view about the future of HSBC in the UK and whether it would keep its domicile. … Douglas Flint said that the domicile was reviewed once every three years and that 2011 would be the year in which that happened …[220]
>
> It became apparent that the shareholders at HSBC, one of the best and biggest banks in the world—and, indeed, one of the most stable—were very upset about paying quite a hefty levy, which only got bigger, on their international earnings. The same applied to Standard Chartered, which had very little earnings within the UK. None the less, in responding to shareholder pressure—the shareholders were asking, of course, for an opportunity to get more return for their money—those chief executives were saying, "Don't worry; we will ride this out and the bank levy will eventually disappear at some point."
>
> After five years of that, the pressure from shareholders was becoming very intense. If Standard Chartered and HSBC had left the country, the bank levy would have had to rise from 24 basis points to more like 35 basis points in order to maintain the £2 billion or so in revenue. Paying 50 basis points would be a very significant taxation on deposit levels within banks. Inevitably, then, if Standard Chartered and HSBC had left, the whole bank levy would have spun out of control and eventually wound itself into a knot that would have been completely unsustainable. That is why the Government had to do something about it.[221]

On this occasion Treasury Minister Harriet Baldwin replied briefly to the debate, highlighting other measures to improve bank competition, and the benefits to building societies and smaller banks from the Government's continued reductions in corporation tax:

> 90% of building societies [will] … be unaffected by these changes. Obviously, the vast majority of building societies do not make a profit of more than £25 million a year, so the sector will benefit from the reduction in corporation tax over the life of this Parliament down to 18% by 2020 … Clearly, a handful of building societies are big enough to be able to pay the additional levy … and, even after the surcharge, they will still be paying a lower rate of corporation tax than they were paying under the previous Labour Government …
>
> The additional steps we have taken to increase bank competition include giving the Financial Conduct Authority and the Prudential Regulation Authority a strong focus on competition; creating the new Payment Systems Regulator to ensure that the challenger banks gain access to the payment systems on fair terms; and introducing a seven-day current account switching service, which is about to have its second anniversary—over 2 million people have now used that simplified switching service. Of course, the Small Business, Enterprise and Employment Act 2015 requires big banks to refer to other organisations any

220 See, *Competition and choice in retail banking: Oral and written evidence*, 2 April 2011, HC 612-II of 2010-12 Qs878-887. Mr Flint also mentioned this in evidence to the Committee later that year (*Independent Commission on Banking Final Report: Oral Evidence*, 23 November 2011 HC1534-v of 2010-12 Q329, Q353).

221 HC Deb 8 September 2015 cc361-2

> small and medium-sized enterprises that it might have turned down for finance …[222]
>
> The hon. Member for Kirkcaldy and Cowdenbeath [Mr Mullin] asked whether the tax regime supports the challenger banks. Of course it does, because the rate of corporation tax will fall to 18% by the end of this Parliament, which means an extremely attractive rate on the first £25 million of profits, and the vast majority of challenger banks will fall into that category. By the end of this Parliament, and taking into account the surcharge, the combined rate for a bank that makes £200 million in profits, for example, will be 25%. That will be a very competitive rate, and it balances the need for revenues to the Exchequer with the need for capital formation in the banking system.[223]

4.3 The CMA's investigation of retail banking (2016)

In August 2016 the Competition & Markets Authority completed an inquiry on competition in the retail banking market, concluding that, "older and larger banks do not have to compete hard enough for customers' business, and smaller and newer banks find it difficult to grow."[224]

As part of the inquiry several stakeholders had made representation about the impact of the Government's reforms to bank taxation, although in its final report the CMA did "not find that the changes are currently deterring entry and expansion or causing exit from retail banking":[225]

> **9.113** Bank levy and Corporation Tax Surcharge (CTS): The six largest retail banks will continue to pay higher effective rates of tax than smaller banks following the changes to the bank levy and the introduction of the CTS.
>
> We have not found any strong evidence that the bank tax changes will deter entry or expansion or will result in retail banks exiting although we recognise that the full impact of the bank tax changes will take time to emerge.
>
> However, there are aspects of the design of the CTS which may lead to differential effects across retail banks which might impact on competition in the future. These include:
>
> (a) the level of the current exemption threshold of £25 million, which if increased could maintain the previous level of tax advantage of smaller banks but we recognise the trade-off between the rate of tax and its coverage in terms of its revenue raising objectives;

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222 [This scheme was implemented by the *Small and Medium Sized Business (Finance Platforms) Regulations 2015*. Further details are on the Business Bank website.]

223 HC Deb 8 September 2015 cc369-370. For an alternative critique of these reforms see, "Osborne should think again on his bank surcharge", *Financial Times*, 25 February 2016.

224 CMA press notice, *CMA paves the way for Open Banking revolution*, 9 August 2016. See also, *Retail Banking: overdraft and credit card charges*, Commons Briefing paper CBP3941, 20 November 2017.

225 CMA, *Retail banking market investigation: final report*, 9 August 2016, p.xxviii, p348

> (b) as set out in Appendix 9.2 [of this report], building societies highlighted the particular impact on mutuals, which are less able to access capital funding through new financial instruments;[226]
>
> (c) the treatment of losses under the CTS compared to standard corporation tax, which may particularly impact recent entrants and smaller banks with legacy losses; and
>
> (d) the application of the CTS to banking entities rather than banking activities, which may give firms with particular structures or non-bank providers an advantage in the longer term.[227]

The report's detailed consideration of the impact of the reforms to banking taxation on the retail market is reproduced below, over the following five pages.

[226] Such as core Capital Deferred Shares issued by Nationwide.

[227] However, the reduction in returns that occurs because of the CTS may also reduce their incentives to expand into deposit holding aspects of the retail banking value chain.

CMA, *Retail banking market investigation: final report*, August 2016

Corporation tax surcharge and bank levy (pp 340-345)

9.81 During the course of the investigation, the UK government introduced the CTS on banks (including building societies) and announced changes to the bank levy including a reduction in the headline rate from 0.21% to 0.10% over the next six years. A number of parties expressed significant concerns with these changes, details of which are set out in Appendix 9.2 [of this report].

9.82 Taxation policy is a matter for government and Parliament. The stated objectives of the changes broadly relate to raising revenue in a more sustainable and fairer way from the banking sector, reflecting the risks the banking system poses to the UK economy. Competition was not an objective of this policy, although HMT submitted to us that the resultant tax regime was consistent with the government's objectives to see greater competition in banking.

9.83 We have considered whether the tax changes in combination lead to differential impacts across banks and whether the changes could deter entry or expansion in, or indeed lead to exit from, retail banking.

We have not sought however to evaluate the policy objectives of the bank tax regime changes themselves, although such objectives provide an important context to our assessment of the potential competition impact of the changes. Similarly, we have not considered any wider effects of the tax regime changes beyond any potential competition impacts or the implications of the changes to the range of non-retail banks affected by the tax changes.

Framework for our assessment

9.84 The levy takes the form of an annual charge on the value of all of the liabilities of the UK banks on a global basis, with a number of exemptions.[1] In particular, the first £20 billion of any bank's taxable debts are exempted. The levy is not a tax on bank profits, but rather on the size of the balance sheet, and therefore has to be paid even when a bank does not make any profit.[2] The levy rate was set at 0.05% at its introduction in 2011 and rose to 0.21% by the budget in March 2015. The bank levy raised £2.2 billion in 2013/14.[3]

Approximately 25 banks in the UK are subject to the bank levy, including non-retail banks. Barclays, HSBCG, LBG, Nationwide, RBSG and Santander are currently subject to the levy. Other providers of PCA and SME banking services are currently exempt because their balance sheet liabilities are less than £20 billion.

9.85 When considering the bank levy liability as a proportion of UK profit, there is substantial variation between banks in the ratio of the bank levy to profits. We estimate that the bank levy costs the six largest banks on average [15– 20]% of their taxable profits. This variation is driven by the exemptions to the levy, reflecting differences in the composition of banks' balance sheets.

9.86 In the summer budget in July 2015, it was announced that there would be a stepped reduction in the bank levy rate from 0.21% to 0.10% over the next six years, and that from 2021 the levy would only be charged on UK balance sheet liabilities. As the bank levy is charged at the balance sheet date, the new rates affect periods ending after 31 December 2015.

Notes

[1] See further Appendix 9.3
[2] Unless otherwise specified, profits refers to profit defined for corporation tax purposes.
[3] HMT, Whole of Government Accounts, p83.

[Retail banking market investigation](): CTS and bank levy contd.

9.87 The Chancellor also announced a new supplementary tax on banking sector profit of 8% to be levied on the profits of all banks and building societies arising after 1 January 2016 (the CTS). The new tax surcharge will be collected alongside corporation tax, similar to the collection of the bank levy.

9.98 The CTS applies to 'total taxable profits' computed for corporation tax purposes, excluding group relief from non-banking companies. Losses arising prior to 2016 are also excluded, which effectively excludes any legacy losses incurred during the financial crisis and start-up losses of recent new entrant banks.[3] There is no carry-forward of unused allowances but there is a £25 million annual allowance, so banks with profits below that level will not pay the surcharge. HMT estimated that between 60 and 100 banks are potentially within scope of the CTS and above the annual allowance.

9.89 HMT submitted to the CMA that the six larger retail banks would remain subject to the bank levy, from which smaller retail banks were exempt due to the £20 billion threshold, and would have an effective additional bank tax rate of 10% or more as a percentage of profits (taking the bank levy and the CTS together). This compares to a bank tax rate of less than 8% for smaller banks with an effective additional rate for the smallest banks of 0% because of the £25 million CTS annual allowance. Around 90% of building societies are not within the scope of the CTS and for banks whose profits are above the £25 million the effective tax rate increases gradually. HMT also noted that it was important to look at the overall bank tax regime and other features of the corporation tax regime which benefit smaller banks including an exemption to the 50% limit on historical losses for losses incurred during a bank's start-up period (ie prior to April 2015) that banks may carry forward to offset their general corporation tax liability.[4]

9.90 As described above the CTS is a tax on accounting profit.[5] As such, this is less likely to distort banks' incentives on price and quality than other forms of taxation. Nevertheless, a tax on profits has the potential to distort banks' investment incentives and the introduction of the CTS will, all else equal, increase the tax liability of both existing banks and potential new entrants. This will lead to a reduction in the rate of returns earned, which would be expected to reduce the attractiveness of investments in banking compared to the next best alternative investment.

9.91 With respect to the bank levy, the reduction in the rate of the levy will, all else equal, result in a decrease in the total tax liability for banks which exceed the £20 billion tax free threshold. We would expect banks to pass through some proportion of this reduction into lower prices or improved service quality. The composition of a bank's balance sheet will also determine how large this reduction will be due to the exemptions built into the levy design.[6]

Notes

3 Whilst the government introduced restrictions in the 2014 Autumn Statement on the proportion of banks' profits that can be offset under standard corporation tax by historical losses (ie losses incurred prior to April 2015) a specific carry-forward allowance was included for building societies. In addition, losses incurred during a bank's start-up period (defined as five years from the point it began trading) were however exempt from the restrictions on carrying forward losses under standard corporation tax.

4 See above on position of losses under corporation tax and also HMT submission on the taxation of banks.

5 Note that the CTS applies to an accounting rather than economic definition of profit. As such it is theoretically possible that a bank is liable to pay the CTS even though it is not covering its cost of capital (and is therefore not making economic profit).

6 ie banks with a higher proportion of short-term debt versus retail deposits, government-backed debt and long-term debt will benefit the most from the reduction in the rate of the levy.

Retail banking market investigation: CTS and bank levy contd.

9.92 In considering the combined effect of the tax changes, we therefore need to consider: the financial impact of the tax changes (and how this varies between banks); and whether and to what extent the tax changes may affect the ability and/or incentives of banks to enter, expand or exit.

The proportionate increase in the total tax liability for larger banks (ie those that are subject to the bank levy and the CTS) may be less than that experienced by some smaller banks. We also note that for some banks (depending on the size and composition of their balance sheet) the combined impact on their tax liability may be negative.[7]

Quantification of the financial impact of the changes

9.93 We examined the impact of the changes on the projected tax liabilities of different banks before and after the changes to the bank levy rates and the introduction of the CTS using data provided to us by HMT from banking groups' 2014 annual reports. Whilst this approach is likely to overstate the impact of the changes,[8] our interpretation of this data is that it broadly shows that the six largest banks (ie those that incur the bank levy) experience an increase in their effective tax rate of between 4 and 6 percentage points. Of the other banks analysed, those with profit below the £25 million tax-free threshold do not experience any increase and those with profit above the threshold experience an increase of up to 7 percentage points.

9.94 We also asked the banks to provide internal documents (including management reports, executive/board papers or strategic plans) which cover the impact of the changes to the tax regime and its potential impact on their business. Where this was not covered by the above material, we also asked each bank to provide its own quantification of the impact of the bank levy and CTS. More detailed information on the evidence provided to us by each bank and the caveats in interpreting the material can be found in Appendix 9.3.

9.95 Table 11 in Appendix 9.3 provides an overview of each bank's estimation of the impact of the changes in the tax regime on their tax liability [**this is reproduced below**]. While there are a number of caveats which limit the comparability of the estimates between banks, we consider that the estimates provide useful information on the size and overall direction of the tax changes. Because the changes in the bank levy impact banks' tax liabilities in a different direction to the introduction of the CTS, it is useful in considering the estimates to distinguish between banks which incur the levy and banks which are exempt from the levy.

9.96 As detailed above, six retail banks incur the levy. Our estimates suggest that initially in 2016, all six banks experience a net increase in their tax liability because the introduction of the CTS is not fully offset by the reduction in the rate of the levy. However, there is some variation in the level of the increase between banks. In aggregate, we estimate that the six levy paying banks will pay around £850 million more in 2016, with [✂] relating to LBG.

Notes

[7] We also note the possibility that the uncertainty associated with changes to the tax regime may have a differential impact on banks, even if the financial implications are similar. This could be the case if there is uncertainty over future levels of taxation and larger banks are better placed to manage this uncertainty. We note, however, that this is a feature in common with all taxes and regulatory interventions. Furthermore, the government has legislated the rates of the bank levy out to 2021 with the specific aim of reducing uncertainty for banks (see HMT, Summer Budget 2015, paragraph 1.204, p46).

[8] Because it does not take into account the change in the base to the bank levy from global to UK balance sheet liabilities in 2021 which will benefit banks with significant international exposure.

Retail banking market investigation: CTS and bank levy contd.

9.97 By 2021, when the levy only applies to UK liabilities and the full reduction in the rate of the levy has occurred, the direction of the net impact varies between the banks depending on the scope of their international activities. In aggregate, the tax liability of the six banks which incur the levy will increase by approximately £200 million (relative to the expected tax liability in 2021 before the introduction of the changes).

9.98 Banks that do not and will not pay the levy will experience no offsetting benefit from the reduction in the levy rate. Overall we estimate that the group of 17 retail banks included in our analysis which are exempt from the levy but liable for the CTS will experience a net increase in tax liability of around £75 million to £95 million in 2016, potentially increasing to £150 million to £170 million in 2021. We note that this group of banks includes both recent entrants as well as established banks with large market shares in the relevant geographic market in which they operate (for example AIB, BoI and Danske).

9.99 In response to our working paper, a multiparty submission[9] from a group of 'challenger' banks[10] cited a piece of research by the Sheffield Political Economy Research Institute which stated that the cost of the surcharge for smaller banks would be greater than that for larger banks as a proportion of total liabilities, raising questions about whether the new surcharge would undermine competition in banking. We note that there are some important limitations (both data and methodological) to the analysis carried out by the Sheffield Political Economy Research Institute such that the results are less robust than our estimate based on banks' own data.

9.100 Overall, our estimates of the financial impacts show that most of the banks analysed will experience an increase in tax liabilities as a result of the tax changes but banks with lower levels of profitability will, all else being equal, have a lower average CTS tax rate (see Table 11 of Appendix 9.3).

9.101 For those banks analysed that are not exempt from the CTS, the combined increase in tax liability as a percentage of profit is between [✂]percentage points. The exceptions to this general result are banks with profitability levels below the £25 million annual threshold and those with high levels of international exposure that are subject to the bank levy. Two of the largest six banks[✂], due to large global activities, experience a net reduction in tax liability by 2021. However, all the six largest banks continue to pay higher effective rates of tax than the smaller banks we analysed.

9.102 In general, we therefore do not find strong evidence of the changes in banks' tax liabilities differing systematically across large versus smaller banks (or across incumbent banks compared to recent entrants).

Notes

[9] Multiparty submission from a group of 'challenger' banks in response to the CTS and bank levy working paper.

[10] Aldermore, Charter Savings Bank, Close Brothers, Hampden & Co. Bankers, Metro, Secure Trust, One Savings Bank, Shawbrook, Tesco Bank and Paragon.

Table 11: Summary of banks' estimates of tax liability changes for 2016 and 2021, relative to the expected tax liability before the changes

Banks	*Change in levy liability (£m)*		*Change in CTS (£m)*		*Combined change (£m)*		*Combined change, % of profit for CTS purposes*		*Combined levy and CTS liability, % of profit for CTS purposes*	
	2016	*2021*	*2016*	*2021*	*2016*	*2021*	*2016*	*2021*	*2016*	*2021*
Six largest banking groups										
Barclays	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
HSBCG	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
LBG †	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RBSG ‡	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Santander	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Nationwideπ	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total of six largest banking groups	**-393**	**-1693**	**1245**	**1894**	**852**	**201**	**[0-5%]**	**[0-5]%**	**[20-25%]**	**[10-15%]**
Other established retail banks										
AIB∆	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Bank of Ireland	*0*	*0*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Clydesdale **	**	**	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Co-op Bank ##	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Danske †	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
TSB ◊	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total of other established retail banks	**0**	**0**	**18-27**	**38-47**	**18-27**	**38-47**	**6-7%**	**7%**	**6-7%**	**7%**
New or recent entrants										
Aldermore□	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Atom	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Coventry Building Society ∂	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Handelsbanken Ā	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Metro Bank *x*	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
One Savings Bank γ	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Paragon p	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Secure Trust Bank	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Shawbrook Bank ϕ	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Tesco	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Yorkshire Building Society ɖ	0	0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total of smaller banks and recent entrants	0	0	**59-69**	**111-123**	**59-69**	**111-123**	**6%**	**7%**	**6%**	**7%**

Source: CMA calculations using data provided by banks.
[✂]

op

Subsequently the implications of these tax reforms for the industry do not appear to have been substantively discussed in the House.[228]

4.4 Rescoping the bank levy (2015-2018)

In December 2015 the Treasury launched a consultation on reforming the scope of the bank levy, to restrict it to UK balance sheet liabilities from January 2021, as previously announced.[229]

A short extract from the consultation document is reproduced below:

> **1.6** Since the bank levy's introduction in 2011, there have been significant developments in international regulation and resolution planning, developments which prompt consideration of the appropriateness of the scope of the bank levy in capturing banking groups' risk to the UK economy.
>
> **1.7** The risk of failure of UK banks' overseas subsidiaries is being reduced by higher loss absorbency requirements and more effective host-state supervision.
>
> **1.8** The impact of such failures is also being reduced through the implementation of internationally co-ordinated resolution planning, simplification in the legal and operational structures of banking groups and, in the UK, the planned ring-fencing of banks' core financial services.
>
> **1.9** The government believes that once these wider reforms have been fully implemented, it will be appropriate to revise the scope of the levy. It therefore announced at Summer Budget 2015 that banking groups will be levied solely on their UK balance sheet equity and liabilities from 1 January 2021.[230]

Subsequently in the Autumn Statement in November 2016 the Government confirmed that it would introduce legislation in 2017 to restrict the scope of the bank levy charge, with certain exemptions:

> **4.27 Bank levy reform** – As announced at Summer Budget 2015, the bank levy charge will be restricted to UK balance sheet liabilities from 1 January 2021.
>
> Following consultation, the government confirms that there will be an exemption for certain UK liabilities relating to the funding of non-UK companies and an exemption for UK liabilities relating to the funding of non-UK branches. Details will be set out in the government's response to the consultation, with the intention of legislating in Finance Bill 2017-18.

228 PQs on the levy in the months after the CMA's report focused on the anticipated yield from these changes, or asked about the Government's position on taxing bankers bonuses: PQs4783 & 4784, 18 July 2017; PQ119992, 21 December 2017.

229 *Spending Review & Autumn Statement*, Cm 9162, November 2015 para 3.62

230 *Re-scope of the Bank Levy – 2021: consultation document*, 9 December 2015 p5. The deadline for responses was 4 March 2016.

> The government will continue to consider the balance between revenue and competitiveness with regard to bank taxation, taking into account the implications of the UK leaving the EU.[231]

On 12 September 2017 the Government announced the date of the Autumn Budget, confirming that it would introduce a Finance Bill after this.[232] At this time the Government published a number of draft clauses to be included in the Bill, in line with previous practice in recent years for publishing much of the Bill in draft for consultation, including provision for the change to the scope of the levy.[233]

On 22 November the Chancellor presented the Budget, and although this particular measure was not mentioned in the Budget report, HMRC's Overview of Tax Legislation noted this measure would be included in the forthcoming Finance Bill:

> **1.27. Bank Levy re-scope**
>
> As announced at Summer Budget 2015 and confirmed at Autumn Statement 2016, the government will change the Bank Levy's scope so that UK headquartered banks are levied only on their UK balance sheet liabilities. Minor changes will also be made to the administration of the Bank Levy …
>
> Following consultation, the draft legislation has been amended to include a number of technical changes to the Bank Levy calculation. The changes to the Bank Levy's scope will have effect for chargeable periods ending on and after 1 January 2021, while other changes will have effect on and after Royal Assent of Finance Bill 2017-18, or for chargeable periods ending on and after 1 January 2018.[234]

The Overview also provided a tax information & impact note on rescoping the levy; this gave a summary of the current law …

> **Current law**
>
> Current law on the Bank Levy is at Schedule 19 to Finance Act (FA) 2011 (Schedule 19).
>
> This sets out the scope of the Bank Levy for UK and overseas banks - including (at Part 4 of Schedule 19) the equity and liabilities on which Bank Levy is chargeable.
>
> Part 4 includes detailed provisions concerning the calculation of amounts on which the Bank Levy is chargeable. This includes rules that allow liabilities to be removed from the chargeable scope of the tax when they are 'netted' against assets recognised on a Bank Levy payer's balance sheet, under a netting agreement.

231 *Autumn Statement 2016*, Cm 9362, November 2016 p39. For details see, *Re-scope of the Bank Levy – 2021: Summary of Responses*, 5 December 2016.

232 HM Treasury press notice, 12 September 2017

233 *Written Statement*, HCWS113, 6 September 2017

234 *Overview of Tax Legislation & Rates*, November 2017 p10

The current law provides separate calculation methods for UK banking groups, overseas banking groups, relevant non-banking groups and banks or building societies that are not members of groups. Bank Levy is chargeable on the worldwide balance sheets of UK banking groups. By contrast, overseas banking groups and relevant non-banking groups calculate Bank Levy amounts due with reference to the activities of only certain group members (for example, relevant UK sub-groups and UK resident entities or branches).

Elsewhere, Part 6 of Schedule 19 concerns the collection and management of the Bank Levy and provides joint and several liability of certain group members for Bank Levy amounts due. Part 6 also requires the annual nomination by a group of a 'responsible member' who will be responsible for meeting the group's Bank Levy obligations.

… and the changes to be made:

Proposed revisions

Winter Finance Bill 2017 will include a rewrite of Part 4 of Schedule 19. This will provide a single set of Bank Levy rules that will apply from 2021 for all Bank Levy payers.

Revisions to Part 4 will provide that, broadly, the Bank Levy will only apply to the UK-based equity and liabilities of:

- members of banking groups that are (i) UK sub-groups, (ii) UK resident entities or (iii) relevant foreign banks with permanent establishments in the UK;
- members of relevant non-banking groups that are (i) UK sub-groups with a UK resident bank as its parent entity, (ii) UK resident banks, (iii) subsidiaries of UK resident banks or (iv) relevant foreign banks with permanent establishments in the UK; and
- non-group entities that are (i) UK resident banks or building societies or (ii) relevant foreign banks with permanent establishments in the UK.

Equity and liabilities attributable to non-UK resident entities will usually be outside the Bank Levy charge.

As part of these changes, groups will also be able to disregard from their Bank Levy calculation any equity and liabilities attributable to overseas branches of UK entities.

Legislation will set out a method for calculating the equity and liabilities that can be disregarded in this way. The revisions also introduce new features designed to simplify the calculation of the Bank Levy. For example, groups will be permitted to choose whether to calculate the equity and liabilities of a sub-group member as part of a wider calculation for the whole sub-group, or on a stand-alone basis. A new deduction from a group's equity and liabilities that are chargeable to the Bank Levy will be available for certain loss-absorbing instruments issued by an overseas subsidiary of a UK resident group member. Full details of the deduction, and the instruments that will be eligible, will be set out in secondary legislation, once the appropriate regulatory standards are in place.

> The 'netting' rules for UK and overseas groups will also be modified, so that amounts owed to any member of the group (whether within or outside the scope of the Bank Levy) can form part of a netting agreement. This will establish a single set of netting rules for both UK and overseas groups.
>
> Revisions to Part 6 of Schedule 19 will replace the current requirement that groups annually nominate a 'responsible member' to meet their Bank Levy obligations with an option to automatically renew an entity's responsible member status. The joint and several liability rules in Part 6 will also be updated, consistent with ring-fencing, which requires large UK banks to separate retail banking activity from the rest of their business. This change will limit the extent to which certain members of a bank's ring-fenced group will be liable for the Bank Levy debts that are attributable to non-ring-fenced entities.
>
> Elsewhere, redundant provisions relating to joint ventures will be removed from Part 5 of Schedule 19.

Notably this impact assessment does **not** give a separate figure for the cost of this change ...

Exchequer impact (£m)

2016 to 2017	2017 to 2018	2018 to 2019	2019 to 2020	2020 to 2021
+415	+555	+365	+225	+105

> These figures are set out in Table 2.1 of Summer Budget 2015 as 'Banks: 8% Corporation Tax Surcharge and changes to Bank Levy' and have been certified by the Office for Budget Responsibility. They represent the combined Exchequer impact of 'Bank Corporation Tax Surcharge' and 'Bank Levy: rate reduction'. The specific component covered in this note has an associated cost to the Exchequer which is incorporated into these figures. More details can be found in the policy costings document published alongside Summer Budget 2015.

... although it makes some comments as to the anticipated impact on business:

> The Bank Levy applies to a small number of banks with chargeable equity and liabilities of £20 billion or more. The changes will reduce the Bank Levy payable by certain banks, by focusing the charge on UK (rather than worldwide) balance sheets. The greatest positive impact is expected to be for UK banking groups that have overseas business activities. The measure is expected to level the playing field between UK and foreign banking groups and reduce the impact of the Bank Levy on these overseas activities.[235]

Provision to this effect was included in the Finance (No.2) Bill 2017-19, published after the Autumn 2017 Budget,[236] and this part of the Bill was debated and agreed, unamended, at the Committee stage of the Bill on 18 December.

235 *Bank Levy: changes to the scope and administration – tax information & impact note* (*Overview of Tax Legislation & Rates*, November 2017 pp112-4)

236 specifically clause 33 & schedule 9 of the Bill (Explanatory Notes to the Bill: EN [Bill 134 of 2017-19] pp83-93).

On this occasion Treasury Minister Mel Stride set out the purpose of this changes as follows:

> [The levy] is currently chargeable on the global balance-sheet equity and liabilities of UK-headquartered banks, but overseas banking groups only pay bank levy on UK activities. However, regulatory developments currently being implemented across the G20 as a result of the standards set by the Financial Stability Board and the Basel Committee on Banking Supervision will reduce the risk that overseas operations of UK banks pose to the UK economy … We have also made it mandatory for the largest UK banks to separate core banking services from their investment banking activities by 2019 … As such, there will now be less need for the bank levy to address the risks posed by overseas operations of UK banks, and as the bank levy is less necessary to cover these risks, we have an opportunity to boost the competitiveness of UK banks by reducing its scope.
>
> At present, UK-headquartered banks pay the levy on their worldwide operations, while foreign-headquartered banks only pay on their UK operations. We want the UK to stay at the forefront of global banking; we want banks based in the UK to compete and win business overseas, bringing jobs, prosperity and tax receipts with them. So we have decided that from 2021 the bank levy will apply only to UK balance-sheets for UK-based and foreign banks alike. This will allow UK banks to compete and win business on a more level playing field in these overseas marketplaces, and it is a change we are making as part of a package of reforms that secures revenue while boosting competitiveness.
>
> The corporation tax surcharge, the reduction in bank levy rates, and changes to compensation relief restriction were legislated in 2015. Following detailed consultation, this clause and schedule implement the final element of our plan: changes to the scope of the bank levy. The clause and schedule narrow the scope of the bank levy so that from 2021 it will be chargeable only on the UK balance-sheet equity and liabilities of banks and building societies. Broadly, this means that overseas activities of UK-headquartered banking groups will no longer be subject to the bank levy. However, the levy will continue to apply to the UK operations of UK and foreign banks.[237]

The Minister went on to oppose new clauses tabled by the Opposition: for reviews of the levy and the 2015 reforms, and the most recent changes to the levy's design …

> We believe that a combination of taxing profits and balance-sheets is the most effective and stable basis for raising revenue from the banking sector … I can assure the House that information about the bank levy will continue to be published as part of the normal Budget cycle. Official statistics are published on the pay-as-you-earn income tax and national insurance contributions, bank levy, bank surcharge, and corporation tax receipts from the banking sector as a whole. The Government have published a detailed tax information and impact note on the proposed changes introduced by part 1 of the schedule. We have also published information about the overall Exchequer impact of the 2015 package of measures for banks, and these figures have been certified by the Office for Budget Responsibility.

237 HC Deb 18 December 2017 cc812-3

and for a public registry of individual banks' levy payments:

> New clause 2 proposes that HM Revenue and Customs should publish a register of tax paid by individual banks under the levy. Taxpayer confidentiality is an essential principle for trust in the tax system, and HMRC does not publish details of the amount of tax paid by any individual business. While this Government continue to consider measures to support transparency over businesses' tax affairs, we must balance that with maintaining taxpayer confidentiality in order to sustain public confidence in our tax system.[238]

Speaking for the Opposition Peter Dowd make the case for these reviews and for publication of each bank's tax liability:

> We seek, first, to require the Government to carry out a review of the bank levy, including its effectiveness in relation to its stated aims … Secondly, we seek to establish the extent of the revenue effects of the cuts made in 2015. Thirdly, we seek to calculate how much would have been raised if the Government had stuck with Labour's bankers bonus tax … We are also calling for a separate review of the changes introduced by clause 33 and schedule 9 and their overall impact on revenue and risky behaviour. That review would make the Treasury explain the rationale for further limiting the scope of the bank levy and forgoing billions of pounds while, at the same time, pushing for more cuts to departmental budgets and frontline services ….
>
> It is, of course, unsurprising and indicative of the Government that they have failed to keep track of the banks that regularly pay the levy and a full list of what they have paid. That is why, in the name of transparency … we would ensure fiscal accountability … The Minister talks about commercial sensitivity … When we supported the banks with billions upon billions of pounds, nobody talked about commercial sensitivity then. In this particular case, I am sure many in the banking sector would be happy to have such transparency. It is shocking that the Government consider this tax cut for the wealthy few to be a good use of nearly £5 billion.[239]

Speaking for the SNP Kirsty Blackman also supported the case for a review of the levy's impact, compared with a payroll tax:

> The suggestion of looking at the effects on revenue of the bank levy compared to the bank payroll tax is utterly sensible. It strikes me that this information should be in the public domain, so that we can all talk from a position of knowledge about the actual effects that this has had, rather than the projected effect that the Treasury thought it would have when it was first put in place or even thinks it might have now …
>
> New clause 1 states that the proposed review would consider "the effectiveness of the levy in reflecting risks to the financial system and the wider UK economy arising from the banking sector". That is key. Despite all that has happened since the financial crash, there are concerns about ensuring that banks continue to make less risky propositions and continue to be safe places for people to put their money.[240]

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238 *op.cit.* c813
239 *op.cit.* cc820-1
240 *op.cit.* cc829-30

The House agreed, on division, to clause 33 & schedule 9, before voting on the first of the Opposition's new clauses, rejecting it by 313 votes to 260.[241] At the Report stage of the Bill on 21 February 2018, the Opposition tabled its clause for a review of the levy a second time. On this occasion Treasury Minister Mel Stride acknowledged that the reductions in the levy rate would see a decline in receipts, but that "it is simply not right to focus only on the declining part of the equation … and not on the fact that we are raising more as a consequence of the 8% surcharge and the increased profitability of banks on our watch." In the event the new clause was opposed by 306 votes to 267.[242]

4.5 Spring Budget 2021 and Autumn Budget 2021: reforms to rates of corporation tax and bank surcharge

In the Spring 2021 Budget on 3 March the Chancellor, Rishi Sunak, announced an increase in the rate of corporation tax from 19% to 25% from April 2023, as part of a series of reforms to corporate taxation.[243] The scale of these reforms is considerable. The Budget report estimated the new rates of corporation tax would raise £11.9 billion in 2023/24, rising to £17.2 billion in 2025/26.[244]

The Budget report noted that "without any other action, due to the additional bank surcharge of 8%, the increase in the main corporation tax rate to 25% would make UK taxation of banks uncompetitive and damage one of the UK's key exports." The Government would review the surcharge and set out in the autumn how it would "ensure that the combined rate of tax on banks' profits does not increase substantially from its current level, that rates of taxation here are competitive with the UK's major competitors in the US and the EU, and that the UK tax system is supportive of competition in the UK banking sector."[245]

Subsequently on 27 October 2021 the Chancellor presented the Autumn Budget and Spending Review, and in his statement announced the bank surcharge would be reduced from 8% to 3%:

> I also said in March that I would review the bank surcharge within corporation tax to maintain the competitiveness of our financial services industry. We will retain a surcharge of 3%. The overall rate for corporation tax on banks will, in 2023, increase from 27% to 28% and will remain higher than the rate paid by other companies. Small challenger banks are improving banking competition,

[241] *op.cit.* cc845-8; cc849-52. The provisions now form s33 & Schedule 9 of the *Finance Act 2018*.

[242] HC Deb 21 February 2018 c244, c248

[243] HC Deb 3 March 2021 cc256-8. For more details see, Corporate tax reform, Commons Library briefing CBP9178, 1 July 2021.

[244] *Budget 2021*, HC 1226, March 2021 p42 (Table 2.1 – item 22)

[245] *Budget 2021*, HC 1226, March 2021 para 2.82

> which is good for the sector and good for consumers, so to help them, I will also raise the annual allowance to £100 million.[246]

Further details of the Government's review were given in the Budget report:

> **Completion of the Bank Corporation Tax Surcharge review**
>
> **2.78** At Spring Budget 2021 the government announced a review of the Bank Corporation Tax Surcharge to establish an appropriate rate in light of the upcoming increase in the main rate of corporation tax from 19% to 25%. The Budget announces the completion of that review.
>
> **2.79** To ensure that banks continue to pay their fair share of tax, while maintaining the UK's financial services competitiveness and safeguarding British jobs and tax revenue, the government is setting the rate of the surcharge at 3% from April 2023. This new rate ensures that banks will continue to pay a higher rate of overall corporation tax than other companies (28% versus 25%) and a higher rate than they did previously (27%).
>
> **2.80** The government will also raise the annual allowance within the surcharge to £100 million to ensure that the tax system is supportive of growth within the UK banking market, promoting competition to the benefit of consumers.
>
> …
>
> **5.67 Bank corporation tax surcharge changes** – Following the government's announcement at Spring Budget to increase the corporation tax rate to 25% the rate of the surcharge will be set at 3% from April 2023. This will ensure that the combined rate of tax on banks' profits is comparable to the UK's major global competitors for banking business, whilst ensuring that banks continue to pay a higher rate on profits than most other companies in the UK, and more than they do now. The annual allowance for groups will also be raised to £100 million to support growth for small and mid-sized banks within the UK banking market and promote competition to the benefit of consumers.[247]

It was estimated that the cost of cutting the rate of the surcharge would be £830m in 2023/24, rising to £1.02bn by 2026/27. HMRC's impact assessment noted that "these costings account for the impact of amending the surcharge only, and thus exclude the revenue raised from the increase in Corporation Tax announced and set out at Spring Budget 2021. Overall, banks will pay more tax as a result of changes announced this year."[248] The Treasury's Policy Costings document explained that in this case the costing "assumes that changing the tax rate will increase the incentive on banking companies to shift profits into the UK."[249]

In its Economic and Fiscal Outlook published alongside the Budget, the Office for Budget Responsibility (OBR) projected that receipts from the bank surcharge will fall from £1.6bn in 2021/22 to £500m a year from 2024/25.

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246 HC Deb 27 October 2021 c283

247 Autumn Budget and Spending Review, HC 822, October 2021 p64, p167

248 HMRC, Amendments to the surcharge on banking companies, 27 October 2021

249 HMT, Autumn Budget and Spending Review 2021: Policy Costings, October 2021 p27. See also, PQ68336, 10 November 2021.

Receipts from the bank levy are forecast to remain around £1.3-£1.2m a year from 2021/22.[250]

Turning back to the costing of the 3% surcharge rate, HMT's Policy Costings noted that the main uncertainties related to this estimate are around the behavioural response to the rate cut. One section of the OBR's Economic and Fiscal Outlook discussed this aspect of the policy costings process:

> **A.36** Policy costings estimating the cost or yield of a new tax measure will typically be broken down into three sections: (i) an estimate of the size of the underlying tax base that will be affected by the measure; (ii) a static costing, which is the difference between the amount of tax raised by the existing and new regimes when applied to the existing tax base; and (iii) an estimated behavioural effect, which aims to capture the way individuals and businesses change their actions in response to the policy – and thereby change the tax base to which the new regime will be applied.
>
> These changes to tax bases often affect more taxes than just the one that is the subject of the measure, so behavioural costs or yields can be large relative to the static cost or yield of the policy change.
>
> **A.37** The scale of the behavioural adjustment depends on the relative ability and willingness of individuals and businesses to respond. It is captured via behavioural elasticities that compare the responsiveness of taxpayers to a given change in the tax rates they face. For some changes these can be based on econometric studies carried out by HMRC or academic institutions based on similar policy changes in the past. For others, judgement has to be relied upon if there is no directly comparable historical or international evidence.[251]

The OBR went on to present the percentage of the cumulative five-year static costing that remains once behavioural responses have been factored in for selected tax policy announcements from both Budgets this year. In the case of the bank surcharge rate it is anticipated that only about 10% of the static yield will be lost. By comparison the OBR estimate that about a quarter of the static yield from the new Health and Social Care Levy - which imposes a 1.25 percentage rise in the rate of NICs paid by employees, employers and the self-employed – will be lost, as over time employers pass on the cost of their higher NICs charge in lower wages for their employees.[252]

HMRC's impact assessment gave further details on the current law and how this will be revised …

> **Current law**
>
> Current law is included in Chapter 4 of Part 7A of the Corporation Tax Act 2010 (CTA 2010), with the rate set at section 269DA of CTA 2010, and the rules for the allowance between sections 269DE and 269DK CTA 2010.

250 OBR, Economic and Fical Outlook, CP545, October 2021 p99, Table 3.4
251 OBR, Economic and Fiscal Outlook, CP545, October 2021 p218
252 OBR, Economic and Fiscal Outlook, CP545, October 2021 p 219, Chart A3. For details of this new tax see, Health and Social Care Levy Bill 2021-22, Commons Library briefing CBP9310, 7 October 2021.

Proposed revisions

> Legislation will be introduced in Finance Bill 2021-22 to amend Chapter 4 of Part 7A CTA 2010. From 1 April 2023, the rate applied to Surcharge profits will be 3%, and the allowance will be £100 million.
> Where a company's accounting period straddles 1 April 2023, the period will be split on a time apportionment basis and the Surcharge will apply at 3% to the profits of the notional period commencing on 1 April 2023.
>
> Where a company's accounting period straddles 1 April 2023, the period will be split on a time apportionment basis, and the Surcharge will apply on the profits of banking companies in a group above their share of the pro-rated allowance for each notional period.

Supplementary Controlled Foreign Companies (CFC) charge

> The appropriate rate to apply in charging the CFC charge for a banking company is a rate equivalent to the total of the UK main rate of CT and the rate for the Surcharge.
>
> Where such a company's accounting period straddles 1 April 2023, the period will be split on a time apportionment basis.

… and the date at which the new surcharge rate will apply:

Operative date

> This amendment will have effect for accounting periods beginning on or after 1 April 2023. Where a company's accounting period straddles 1 April 2023, the period will be split on a time apportionment basis and the Surcharge will apply at 3% to the profits of the notional period commencing on 1 April 2023. The allowance will be split on a time apportionment basis so that the increased allowance applies to the notional period commencing on 1 April 2023.[253]

There was relatively little comment on the new bank surcharge in the coverage of the Budget, although it was raised when the Chancellor gave evidence to the Treasury Select Committee on the Budget and Spending Review on 1 November. On this occasion Siobhain McDonagh suggested that the Chancellor was "cutting tax on banks to the effect of £4 billion by 2027":

> **Rishi Sunak**: The impact of the surcharge change in isolation is several hundred million pounds, but you have to look at the increase. You cannot look at that in isolation. You have to look at it combined with the fact that the core underlying corporation tax on banks is going up from 19% to 25%, so banks are going to pay more corporation tax in the future than they did in the past.
>
> **Siobhain McDonagh**: But less tax surcharge.
>
> **Rishi Sunak**: The composition of the tax is obviously changing, and I said that at the time. If your surcharge rate is going up, we are resetting the surcharge rate.[254]

253 HMRC, Amendments to the surcharge on banking companies, 27 October 2021

254 Treasury Committee, Oral evidence: Autumn Budget and spending review 2021, HC 825, 1 November 2021 Q132

Provision to this effect was included in the Finance (No.2) Bill 2021-22 (specifically clause 6 of the Bill), which was one of the clauses in the Bill considered by the Committee of the Whole House on 1 December.[255]

On this occasion the Financial Secretary, Lucy Frazer, argued that keeping the surcharge at 8% "would have led to banks paying an effective rate of 33% on their profits" which would "have put us at a competitive disadvantage in relation to other major financial centres, such as the US, Germany and France." She went on to note that the changes to corporation tax and the bank surcharge would "result in banks paying an additional £750 million in tax over the period to 2026-27 based on current forecasts."[256]

Speaking for the Opposition James Murray opposed the reduction in the surcharge, contrasting this tax cut with the Government's proposal to increase the rates of National Insurance contributions from April 2022. He also made the case for a review to consider "the total revenue raised by the banking surcharge since its introduction, alongside the total public expenditure on supporting the banking sector since 2008, and an assessment of risks to the banking sector in the future, including the likelihood of further public support being required" – the object of a new clause that the Opposition had tabled:

> I would welcome the Government's support for such a review, but if it is not forthcoming, perhaps the Minister could explain why the need for banks to make an additional contribution to public finances is suddenly less now than it has been for the past decade. Without clear evidence from the Government, we can only go on what others say. Tax Justice UK has pointed out that "it appears that the bank levy and bank surcharge will not even have fully repaid the public expenditure on the banking sector at the financial crisis; let alone provided any insurance against a future crash, before being cut". It is clear that cutting this tax on banks is the wrong choice at the wrong time.[257]

For her part the Financial Secretary rejected the case for a review on the grounds that it would provide "no new information":

> The Government already publish figures on revenues raised from the bank levy introduced in 2011 and the banking surcharge introduced in 2016 in the Red Book at each Budget. On state support, as of 27 October this year the independent Office for Budget Responsibility estimated an implied balance, excluding financial costs, of £13.5 billion for the net direct effect from the public finances of financial sector interventions made as a result of the 2007-08 crisis. ...
>
> Since the financial crisis, we have introduced regulations that reduce the potential risk and shift costs away from the taxpayer. Indeed, today's banking system is much stronger than at the time of the financial crisis, and banks hold three times more capital. The Bank of England's Financial Policy Committee is required to publish two financial stability reports a year. The committee

255 HC Deb 1 December 2021 cc959-1015

256 op.cit. c963. In answer to a PQ at this time Treasury Minister John Glen confirmed that "no separate assessment of the increase in corporation tax receipts solely from banks has been made" (PQ76727, 24 November 2021).

257 op.cit. c967

> judged in September that the banking sector remains resilient to outcomes for the economy that are much more severe than the Monetary Policy Committee's central forecast—a judgment that is supported by the interim results of the Bank of England's 2021 solvency stress test.[258]

In the event the House voted on clause 6, and approved it, unamended, by 301 votes to 206.

[258] op.cit. cc963-4