Details of proposed UK bank levy published: the UK and international context

Introduction
On 13 July 2010, the UK Treasury published a Consultation Document on the proposed UK bank levy (the Levy). The introduction of a Levy from 2011 was announced in the new UK Coalition Government’s first Budget on 22 June 2010. The Consultation Document sets out details of the UK Government’s proposed approach to the Levy.

The proposed Levy would, in particular, apply to the consolidated balance sheets of UK headed banking groups, and to UK branch and subsidiary balance sheets of non-UK banking groups. There is a threshold, so that the Levy would apply only if the aggregate liabilities subject to the Levy amount to £20 billion or more. The UK Treasury anticipates that, accordingly, the Levy will affect 30 to 40 banking groups.

While the UK Government considers that the structure of the Levy is intended to encourage banks to move away from riskier funding models, reducing systemic risk, it also expects the Levy to generate around £2.5 billion of annual revenues once fully in place.

There follows a summary of the details and options set out in the Consultation Document, and of developments in other jurisdictions – particularly the United States, France and Germany. Proposals for a US bank levy were initially set out in early 2010 (although, as detailed below, they have since encountered setbacks), while France and Germany, together with the United Kingdom, issued a joint statement in June of their intentions to introduce bank levies.

In the United Kingdom, the consultation on the Levy runs until early October and, with draft legislation not due to be published until later in 2010, the legislation that is ultimately enacted may differ significantly from the current proposals.

Tax base
The Levy is proposed to apply to:

- The global consolidated balance sheet of UK banking groups and building societies;
- The aggregated subsidiary and branch balance sheets of non-UK banks and banking groups operating in the United Kingdom; and
- The balance sheets of UK banks in non-banking groups.

The proposal is to base the definitions of “bank” and “banking group” on concepts used in the UK Bank Payroll Tax legislation which applied with respect to bank employee bonuses up to 5 April 2010 (as modified to reflect the application of the Levy to the consolidated accounting group). The definitions used in the Bank Payroll Tax legislation include some firms which are not deposit-takers in the traditional sense of banking, but which have broker-dealer or mortgage lending
businesses. Most investment banking groups will therefore be captured by these proposals. Certain firms such as asset managers, commodities traders, retail brokers of contracts for differences and insurance companies are not proposed to be subject to the Levy.

**Liabilities and exclusions**

The Levy will be based on the total liabilities and equity reported in the relevant accounts (with certain exclusions detailed below). Liabilities are to be calculated on a gross basis, except that derivatives with the same counterparty may be permitted to be reported on a net basis in accordance with Basel II principles.

The focus on the liability side of the balance sheet is in accordance with the IMF report to the G-20 published on 27 June 2010 (the IMF Report). The IMF Report concludes that using other bases for a bank levy – for example, looking at the asset side – could duplicate regulatory capital requirements that target risk on the asset side. A bank levy based on liabilities seeks to avoid this duplication, and may have behavioural consequences for bank groups’ reliance on short-term funding.

The Consultation Document proposes that certain items are excluded from the tax base of the Levy, namely: (1) Tier 1 capital (in order not to discourage capital accumulation); (2) insured retail deposits (for instance, deposits coming within a state-run guarantee or insurance system); (3) repo liabilities secured against sovereign debt (a proposed test is whether the sovereign debt would meet the criteria of the UK Financial Services Authority, the principal UK financial regulatory authority, for inclusion in a bank’s liquid assets buffer); and (4) policyholder liabilities of retail insurance businesses. These exclusions also reflect the recommendations in the IMF Report.

**Relevant balance sheet**

Subject to the exclusions summarised above, the intention is that taxable liabilities and equity will be measured from the relevant balance sheet. For UK-headed banking groups, this would be the global consolidated balance sheet prepared under IFRS.

For non-UK headed banking groups, the intention is to judge whether an entity is a member of the group by reference to the consolidated group for accounting purposes, at least where financial statements are prepared under either IFRS or US GAAP. The taxable balance sheet of a UK sub-group or a non-UK entity with a UK branch would then be the sub-group or branch balance sheet, which would need to be prepared under IFRS or UK GAAP (aggregating sub-group and branch balance sheets if there are both).

Where a non-UK bank has a UK branch, it will apply rules already in place to determine the correct attribution, for UK corporation tax purposes, of the bank’s assets and regulatory capital to the branch; the proposal is that similar principles will apply to attribute the right proportion of the entity’s liabilities and capital to the branch for the purposes of the Levy (although the Consultation Document lists potential options for the most appropriate calculation methodology to apply these principles).

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Rates and ancillary provisions

The main rate of the Levy is proposed to be 0.04 per cent. in 2011, rising to 0.07 per cent. in 2012 and thereafter.

However, funding with more than one year to maturity at the operative balance sheet date will be subject to half the main rate (that is, 0.02 per cent. in 2011, rising to 0.035 per cent. in 2012 and thereafter). Intra-group liabilities of the UK part of a non-UK group will be deemed to be short-term, except to the extent that these liabilities can be shown to be backed by external long-term funding.

The Levy will not be deductible for UK corporation tax purposes and is proposed to be payable by instalments.

Where the accounting period of a banking group does not match the calendar year, the liability as at the balance sheet date will initially be computed as normal; however, the result will then be time-apportioned, so that the rate of the Levy for a calendar year will only apply to the proportion of the accounting period falling within that calendar year.

Anti-avoidance provisions will be introduced which, broadly, are intended to operate to ignore arrangements where one of the main purposes is to reduce or eliminate a group’s liability to the Levy. The provisions will be designed in particular to discount transactions entered into around the balance sheet date to disguise the true funding profile; however, arrangements reflecting a real change in the funding profile of the group towards longer term or excluded liabilities would be in line with the policy intentions of the Levy, and would not constitute avoidance for these purposes. The Levy will be added to the list of UK taxes that are subject to the existing UK Disclosure of Tax Avoidance Schemes regime.

The Consultation Document includes a commitment to review the design and operation of the Levy in 2013.

Copies of the Consultation Document can be obtained at http://www.hm-treasury.gov.uk/d/consult_bank_levy_condoc.pdf. Comments are invited by 5 October 2010.

Observations on the UK bank levy

Many commentators have noted that, on the face of it, applying the Levy to the consolidated balance sheets of UK-headed banking groups puts them at a disadvantage to banking groups established in other jurisdictions. The consolidated balance sheet includes liabilities and regulatory capital which are attributable to the group’s activities outside the United Kingdom, and there is clearly scope for duplication if these items are also subject to a bank levy where non-UK operations are located.

There is potentially more scope for non-UK headed banking groups with a UK presence to reassess the location of their books, in light of bank levy rates across the relevant jurisdictions, particularly if the home jurisdiction does not follow the UK model of bank levy.

It is conceivable that we may eventually see some competition between jurisdictions on the rate of their bank levies (where a bank levy has been introduced at all), as well as on other aspects of banking regulatory systems. The Consultation Document notes that the rate at which each country’s bank levy is set should take into account the need for a level playing field. That said, the rate will of course be a matter for each of the authorities concerned.

The Consultation Document recognises that double taxation will be an issue and notes that, because existing tax treaties focus on double taxation of income or gains, they are not apt to cover a balance sheet levy. There is a commitment to consider mechanisms to alleviate double taxation and to take forward urgent discussions with other countries planning to introduce a similar levy. However, no more details are given in the Consultation Document on this area.

On the details of the Levy, it is notable that off-balance sheet liabilities are not covered which, again, can be expected to influence behaviour. Given the special treatment proposed for intra-group lending, non-UK headed banking groups will need to review intra-group funding of their UK operations, to ensure that long-term funding is treated as such.
In addition to a levy on bank balance sheets, the IMF Report proposed a separate “Financial Activities Tax” on the financial sector. While the Consultation Document does not discuss this second bank tax, the UK Government stated in the June Budget that it would work with international partners to explore the costs and benefits of a Financial Activities Tax on profits and remuneration; more recently, the Financial Secretary to the Treasury, Mark Hoban, has said that the Government is “actively looking” at a Financial Activities Tax in addition to the Levy.2

International position

It is notable that the United Kingdom is consulting internationally before moving forward with a Financial Activities Tax, but has pressed ahead with the Levy without waiting for an international consensus.

The participants in the June G-20 summit, for which the IMF Report was prepared, agreed to differ on the global implementation of a banking levy. The communiqué from finance ministers agreed that banks should share the burden where governments had intervened to repair their banking systems, but also recognised that there was a range of policy options for each country taking its individual circumstances into account. In the face of opposition to a universal banking levy, principally from Australia, Canada and Japan as well as emerging economies, it was agreed that individual countries could introduce their own levies where appropriate, but plans for a co-ordinated global levy were dropped.3

Various jurisdictions continue to press ahead with domestic bank levies. Sweden introduced a bank levy in 2009. At the time of the UK Budget on 22 June 2010, France, Germany and the United Kingdom issued a joint statement of their intention to introduce levies on bank balance sheets. Germany intends to apply the levy to a resolution fund against future banking crises, whereas in the United Kingdom and France the levy is expected to be included within general taxation rather than a resolution fund. Meanwhile, France and Germany continue to support proposals for a “Tobin tax” on financial transactions in the European Union, although this does not feature in the IMF Report.4

The following sections summarise developments in the United States, France and Germany.

United States

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act), as reported by the House-Senate conference committee on 26 June 2010, initially proposed to impose risk-based levies on financial companies with at least US$50 billion in assets. For the purposes of the Act, “financial companies” would have included US bank holding companies and their subsidiaries. Unlike a tax, the levy was to be administered by the Federal Deposit Insurance Corporation, rather than the Department of the Treasury.

4 “France and Germany push for transaction tax”, Financial Times, G. Wiesmann (http://www.ft.com/cms/s/0/e64dd66c-8b49-11df-a4b4-00144feabdc0.html).
This proposal, however, was met with opposition in both the House and the Senate. It was eventually deleted from the financial reform legislation that was ultimately enacted by Congress.

It is notable that the bank levy provision was originally inserted into the Act at an advanced stage of the legislative process, which happened to coincide with the June G-20 summit in Toronto. The Obama administration has consistently voiced its support for the imposition of a bank levy similar to that initially proposed in the Act. To date, however, strong opposition by a variety of members of Congress has prevented the administration from achieving that goal.

France
The French bank levy will be introduced in the Finance Bill for 2011. The levy is expected to be assessed on banks’ assets, weighted by the risks of these assets. As noted above, proceeds should be allocated to the general budget of France rather than to a specific fund.

Details of the levy (including its scope, basis and rate) will be provided in the draft Finance Bill for 2011, which should be released by the French Government in late September 2010.

Germany
At the end of June 2010, the first draft of a “Law for the Installation of a Restructuring Fund for Credit Institutions” was published as part of a complex bill regarding the restructuring of credit institutions. The German bank levy is intended to serve the financing of a newly-established restructuring fund. For this reason, it does not have the character of a tax, but is structured as a contribution (the Contribution) to the restructuring fund.

Under the provisions of this draft, only German banks would be protected by the fund. Therefore, only German banks would be subject to the Contribution, whereas non-German banks providing financial services in Germany through a branch should not be affected. Other financial institutions such as insurance or investment companies would not fall into the scope of the Contribution either.

A two-tier methodology would apply to the calculation of a bank’s annual Contribution. The Contribution depends on the amount of certain liabilities (Relevant Liabilities) and, separately, an amount relating to derivatives (Relevant Derivatives).

To determine Relevant Liabilities, the total of all liabilities and equity as shown in the most recent financial statements of the bank is reduced by: (1) liabilities owed to customers; and (2) liable equity (a technical term in German banking law). The annual Contribution in relation to Relevant Liabilities is equal to the amount of the Relevant Liabilities multiplied by a factor ranging from 0.02 per cent. (for Relevant Liabilities of less than €10 billion) to 0.04 per cent. (for Relevant Liabilities of more than €100 billion). As a second step, an amount equal to 0.00015 per cent. of Relevant Derivatives is added to produce the total annual Contribution.

The annual Contribution is capped at 15 per cent. of the annual net income as shown in the bank’s most recent financial statements. The Contribution is not deductible for German tax purposes. However, additional extraordinary Contributions may be levied if further funds are needed; if levied, these additional amounts would reduce the German tax base.
Conclusions
As can be seen from the discussion above, this is still a developing area. The United Kingdom is consulting on its proposals, and the United States, France and Germany are at various stages in terms of their legislative process.

Further details and updates can be obtained from your Shearman contact in our offices across the relevant jurisdictions.