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# The UK banking sector and the corporation tax surcharge.

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In this Brief, the Sheffield Political Economy Research Institute considers the impact of the changes to taxes on banks made by the Chancellor of the Exchequer in his Budget in July 2015, specifically the introduction of an 8 per cent corporation tax surcharge on bank profits. The surcharge will be introduced in the context of a significant reduction in the 'Bank Levy', which was introduced in 2011. The Brief therefore assesses the impact of the new surcharge on three categories of banking institutions: the big global banks headquartered in the UK; building societies; and challenger banks. It looks at the rationale used to make the tax changes and in doing so raises questions about the purpose and proportionality of taxes levied upon banks in the UK.

## Background

- The Bank Levy was introduced in 2011 so that banks '*make a full and fair contribution in respect of the potential risks they pose on the wider economy*'. The Levy is a tax on the global balance sheets of UK and foreign banks which operate in the UK and is paid by banks whose total liabilities exceed £20 billion. The current bank levy rate is 0.21 per cent.

- The levy has raised £8 billion for the Exchequer since 2011. It is estimated that 30 banks are subject to the levy and that 70% of the bank levy comes from the 'Big 5' banks.

- Two changes to bank taxes were announced in George Osborne's Budget in July 2015:

    1. The Bank Levy rate fell to 0.18 per cent on 1 January 2016 and will now fall annually until 2021 when it will reach 0.10 per cent. From 2021 the levy will only apply to the UK balance sheets of banks.
    2. A new 8 per cent corporation tax surcharge on the profits of banks, in addition to existing corporation tax at 18 per cent, came into force on 1 January 2016. It applies to all banks with annual profits over £25 million. It is estimated that over 200 banks, building societies, and new 'challenger' banks will be eligible for the new surcharge.

- In his Budget speech the Chancellor said the two taxes combined would raise more revenue from the banks between 2015-2020 than they had provided between 2010-15.

- However, there is a need to consider the specific impact of the corporation tax surcharge on challenger banks, who are in practice exempt from the Bank Levy because their liabilities do not exceed £20 billion.

- Challenger banks are new banks which aim to compete with large, long-established banks. Many have been established since the global financial crisis. Challenger banks have raised concerns that the surcharge could threaten their ability to secure investment to grow, and could prevent new challenger banks from entering the market. The Brief also considers the impact of the surcharge on building societies which, like challenger banks, cannot be considered to pose a systemic risk to the UK economy.

- The Bank Levy is forecast to raise £3.7bn in the current financial year (2015/16). At the March 2015 Budget when the levy was raised to 0.21 per cent the Office for Budget Responsibility (OBR) forecast that it would raise £18.5bn between 2015/16 and 2019/20.

- As a result of the changes made to the Levy in the July 2015 budget the OBR forecasted that the Bank Levy will now raise £13.1 billion between 2016/17 and 2020/21. As the rate of the levy reduces over the next five years its annual contribution to the Exchequer is forecast to decrease from £3.1bn in 2016/17 to £2.2bn in 2020/21.

- The OBR has forecast that the new surcharge will raise £6.5bn between 2016/17 and 2020/21. The Brief therefore considers the implications for smaller financial institutions of this deliberate shifting in revenue generation from the Bank Levy to the corporation tax surcharge, and what this tells us about the nature of bank taxes in the UK.

## Evidence

- To assess the impact of the new surcharge we have estimated the additional amount of corporation tax that will be paid by four challenger banks, the four largest building societies, and the four largest banks headquartered in the UK. Estimates were calculated using published profits before tax for the year ending 2014, the last available year for which a full set of results for all banks is available.

- These three categories of banks represent examples of small, medium and large banking institutions operating in the UK. The four challengers are representative of new challenger banks that have been established since the crisis and received initial early backing from private equity. None are big enough to pay the Bank Levy. The four building societies are the largest in the UK sector, but only three have high enough liabilities to pay the Bank Levy. The four largest banks are representative of global banks which operate across multiple jurisdictions, all have their headquarters in the UK and all pay the Bank Levy.

- Estimating corporation tax payments from published profit figures is notoriously difficult, especially for global banks headquartered in the UK, due to the lack of transparency for how banks allocate profits between different jurisdictions, and pay tax accordingly. Since 2012 the profits of foreign branches of a UK company have been exempt from corporation tax.

- This difficulty is acknowledged by the OBR who stated, in Budget documents published by the Treasury in July 2015, that the modelling required to assess the impact of the new surcharge and Bank Levy is complex.

- The 2014 profits for the challenger banks – Aldermore, OneSavings Bank, Shawbrook and Secure Trust Bank – ranged between £26-63 million and so all will be liable for the surcharge. Many challenger banks do not have annual profits over £25m and so will not be liable.

- Applying the 8 per cent surcharge to the challengers' 2014 profits mean we estimate that they would have contributed between £88,000 and £3.04 million.

- Considering the 2014 profits of four building societies – Nationwide, Yorkshire, Coventry and Skipton – mean we can estimate that their surcharge contributions would have ranged between £10-52 million.

- Considering the 2014 profits of the four biggest banks headquartered in the UK – Lloyds, HSBC, RBS and Barclays – provides estimates showing that each bank is likely to contribute hundreds of millions through the surcharge, notwithstanding the fact that the big banks are able to allocate profits between different jurisdictions, and pay tax accordingly.

- However, if the surcharge estimates for each category of bank are considered as a percentage of their overall balance sheet questions of proportionality are raised:

    - ◊ As a percentage of their balance sheets the challenger banks' average surcharge would equate to a tax of 0.044 per cent of their total liabilities.

    - ◊ For the building societies the average surcharge would equate to a tax of 0.045 per cent of their total liabilities.

    - ◊ The big four banks' would pay a surcharge which equates to a tax of just 0.028 per cent of their total liabilities.

- Individual surcharge estimates for the four challenger banks, four building societies, and the four large banks are available in the annex.

## Analysis

- When the Bank Levy was introduced it had two objectives: to raise revenue from the biggest banks, primarily those the Government bailed out in 2008, and to '*encourage banks to move to less risky funding profiles*'.

- The declining rate of the Bank Levy will reduce its contributions to the Exchequer from 2015/16, and the shift to UK balance sheets will further reduce contributions from 2020/21.

- The corrective emphasis of the Levy was demonstrated by applying the Levy to global balance sheets. This recognised that it is the overall size of the big bank's global liabilities that provide risk to the UK economy. By announcing that the Bank Levy from 2020/21 will only apply to UK balance sheets the Chancellor signalled that the objective of the Levy is shifting from being a corrective mechanism, towards more fully becoming a source of revenue – albeit a substantially reduced source of revenue.

- Such a shift may well be justified, however it raises questions about the authenticity of the Government's intent to encourage greater diversity within the UK banking sector and reduce the market share of the big banks.

- The Bank Levy contributions from the largest banks will still provide most of the overall total that the Levy raises. Whilst most challenger banks and building societies will remain exempt from the Bank Levy they will now face a higher tax burden through the surcharge. This could affect their ability to raise investment.

- Treasury Budget documents describe the surcharge and changes to Bank Levy as one combined policy, and the two taxes are costed as one policy measure. By explicitly linking the two taxes together the Treasury is removing the distinction between the biggest banks that pose a systemic risk to the UK economy, and all banks in the UK, whatever their size.

- Many challenger banks did not exist in 2008 or were extremely small. Further, the challenger banks and building societies currently have balance sheets that are far smaller than the biggest banks, and therefore it is reasonable to argue that they pose a lower systemic risk to the UK economy.

- As other scholars have noted there is a lack of transparency for how the big banks allocate taxable profits between jurisdictions.[1] As a result it is very likely that our estimates for how big their surcharge contributions are over-estimated. However, it is reasonable to assume from these estimates that the biggest banks will be the largest source of revenue from the new surcharge.

- Smaller challenger banks and building societies whose business activities tend to be largely UK-based will as a result be less able to reallocate profits to other jurisdictions. It is therefore reasonable to assume that our estimates for their surcharge contributions can be made with a higher degree of certainty than for the global banks.

- The surcharge contributions of challenger banks and building societies will be substantially less than the biggest banks, but yet our estimates show that the surcharge they will pay in proportion to their balance sheet is set to be higher than for the big banks. This raises questions of fairness regarding how the taxation regime for banks in the UK is structured.

## Conclusion

The changes to the Bank Levy introduced in July 2015 will over the course of the current parliament reduce the tax contribution that the biggest banks make through the Bank Levy, and this will significantly reduce further from 2021. Over the same period the new corporation tax surcharge will increase the tax revenue from small and medium size banks and building societies. Based on the available data our estimates suggest that challenger banks and building societies will pay a higher surcharge as a proportion of their liabilities than the biggest global banks based

1 Meeks, G and Meeks, J. G. (2014) Why Are Banks Paying So Little UK Corporation Tax? Fiscal Studies. 35 (4), 511-533.

in the UK. This raises questions about whether the new surcharge will undermine diversification in the UK banking sector.

Furthermore, by introducing the new surcharge on the profits of *all* banks the Chancellor shifted the emphasis underpinning his bank tax regime from being a corrective mechanism to tilt banks away from risky lending towards revenue raising. In light of this changing objective the Treasury needs to clarify what the purpose of bank taxes are, this particularly applies to the Bank Levy. Small and medium size challenger banks and building societies may feel that it is unfair to be asked to pay additional taxes to make reparations for the global financial crisis of 2008; a crisis that arguably they did little to contribute to, compared to the role of the biggest global banks.

## Annex: Estimated surcharge contributions (all figures £ million)

| Global banks headquartered in the UK | Lloyds | HSBC | RBS | Barclays |
|---|---|---|---|---|
| Total Liabilities (as of 31/12/14) | 804,993 | 1,570,426 | 990,571 | 1,291,948 |
| Profit Before Tax (as of 31/12/14) | 1,762 | 12,051 | 2,643 | 2,256 |
| Profit Before Tax (minus £25m allowance) | 1,737 | 12,026 | 2,618 | 2,231 |
| Application of surcharge (8%) | 138 | 962 | 209 | 178 |
| **Surcharge as percentage of total liabilities** | **0.017** | **0.061** | **0.021** | **0.013** |

| | |
|---|---|
| **Average surcharge as percentage of total liabilities** | **0.028** |

| Challenger banks | Aldermore | OneSavings | Shawbrook | Secure Trust |
|---|---|---|---|---|
| Total Liabilities (as of 31/12/14) | 5,186 | 4,686 | 2,535 | 657 |
| Profit Before Tax (as of 31/12/14) | 50 | 63 | 45 | 26.1 |
| Profit Before Tax (minus £25m allowance) | 25 | 38 | 20 | 1.1 |
| Application of surcharge (8%) | 2 | 3.04 | 1.6 | 0.088 |
| **Surcharge as percentage of total liabilities** | **0.038** | **0.064** | **0.063** | **0.013** |

| | |
|---|---|
| **Average surcharge as percentage of total liabilities** | **0.044** |

| Building societies | Nationwide | Yorkshire | Coventry | Skipton |
|---|---|---|---|---|
| Total Liabilities (as of 31/12/14) | 181,020 | 35,611 | 29,787 | 14,909 |
| Profit Before Tax (as of 31/12/14) | 677 | 188 | 201 | 156 |
| Profit Before Tax (minus £25m allowance) | 652 | 163 | 176 | 131 |
| Application of surcharge (8%) | 52 | 13 | 14 | 10.4 |
| **Surcharge as percentage of total liabilities** | **0.028** | **0.036** | **0.047** | **0.069** |

| | |
|---|---|
| **Average surcharge as percentage of total liabilities** | **0.045** |

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