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Our response to European Commission's consultation paper on additional taxation measures for the financial sector

Introduction

The Building Societies Association represents mutual lenders and deposit takers in the UK including all 48 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for about 36% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

We are pleased to be able to offer a short, high-level response to the substantial issues raised in the consultation. While we understand why these measures are being proposed, we do not consider they should be imposed, in general, on the UK mutual sector (which did not cause the financial crisis) since the key reasons for imposing additional taxation do not apply to them either, as we explain below. Mutuals such as UK building societies were in fact among the victims of the crisis caused by undesirable behaviours of the banks. At a more general level, we also find that the basic proposal for additional taxation is uncoordinated with, and arguably inconsistent with, other EU initiatives for banking crisis prevention and management.

Background

The Commission's consultation sets out the following reasons for future additional taxation of the financial sector:

- there has been substantial public support for the sector during the financial crisis
- there has been possible under-taxation of the financial sector
- there have been undesirable behaviours in the sector, such as excessive risk-taking
- there has been an uncoordinated patchwork of national measures that could distort competition and/or lead to double taxation.

Issues of principle

Our response to the issues raised above is limited to the more significant issues of principle, which are as follows:

1. Substantial public support

Taxation that is based on this principle should arguably be based on the level of direct support actually provided and therefore should be met mainly by the failed and rescued banks. Mutuals such as building societies were, in general, victims of the crisis caused by undesirable behaviours of the banks. Failures elsewhere in the banking sector meant that some building societies accessed central bank assistance, on a modest scale and against collateral, through the Special Liquidity Scheme, but much larger amounts were drawn by banks.

Mutuals are repaying SLS drawings through 2011 and 2012. Failures in the mutual sector were minimal and were supported from within the sector itself – no mutual credit institution in the UK:

- had to be taken over by the state ;
- needed to be recapitalised at taxpayer expense ;or
- needed to secure state guarantees – again, contingently, at taxpayers' expense – for their bad loans.

So, essentially all the longer-term public support in the UK was required by plc banks not mutuals.

Moving on from the question of past support during the crisis, the major impetus of the EU regulatory reforms under both the Capital Requirements Regulation, and the latest Commission proposals on a crisis management framework, is to make credit institutions much more resilient, and manage their failure so as to avoid or minimise any future public support. So the premise - of substantial public support in future crises – is being designed out of the system – therefore it cannot be a valid justification for ongoing taxation.

2. Under-taxation of the financial sector

Building societies and other mutual credit institutions in the UK already pay an aggregate level of taxes and levies beyond what is fair and reasonable. First, mutuals already pay their fair share of basic corporate taxation – they do not generally indulge in artificial tax avoidance using complicated schemes or offshore havens. So much will be plain to see from our members' published accounts. Second, larger mutual credit institutions are already subject to the UK's current bank levy on the same basis as plc banks. Third, the Financial Services Compensation Scheme[1] levy, under which the UK building society sector shares the burden of resolving failed institutions or compensating their depositors, should also be regarded as additional taxation for these purposes since the cost of this support would have to be met otherwise from the public purse. And mutual credit institutions – whose purpose is not to make profits for rentiers, but to serve their individual members, already face the prospect of even greater FSCS burdens from the current EU plans for the pre-funding of deposit guarantee schemes – this in itself will drain a large amount of any surpluses over the next decade. Any further taxes would therefore represent an undeserved additional burden to a mutual sector that is operating in a prolonged low interest rate environment and in a period of slow recovery from recession.

3. Undesirable behaviours in the sector

Additional taxation based on this principle must be properly related to the evidence of such behaviour. Failed but rescued institutions, institutions which continue to have high risk profiles and/or institutions paying excessive remuneration should therefore bear the main burden of any additional taxation raised on this basis. In general, mutual credit institutions are none of these things. Applying these principles will therefore tend to exclude mutuals , not simply because they are mutuals, but on the actual evidence of undesirable behaviour.

4. Patchwork of national measures

The consultation makes it clear that there is already a patchwork of national bank levies. The introduction of coordinated additional forms of taxation, in the form of a FAT or FTT, will not deal with this existing patchwork. This can only be dealt with either (a) by a coordinated levy applied according to similar principles in all EU or G20 jurisdictions or (b) by the abolition of the patchwork of national bank levies and their replacement with a coordinated and uniform FAT or FTT. The UK mutual sector considers that, considers that, if additional taxes are to be imposed, the least harmful option may be the abolition of the UK bank levy and the introduction of a uniform rent taxing FAT as detailed below.

[1] The FSCS is the UK's deposit guarantee scheme which also operates already as a bank resolution fund

The structure of possible additional taxation measures

Comments on the structure of any FAT, FTT or coordinated levy will be subject to the political considerations described above. Subject to this, we wish to make the following observations:

1. The structure of a FTT

We see flaws with the FTT concept. Restricting FTT to the EU because there may never be a G20 agreement is likely to lead to the very issue it identifies, namely relocation of activities outside the EU and distortion of competition for those institutions unwilling or unable to relocate activities or transactions outside the EU. Also, a G20 agreement, even if it could be reached, does not provide certainty on a truly global level that relocation would not follow as the G20 does not cover tax havens. As the consultation acknowledges however, there may never be a G20 agreement, so neither an EU level nor a G20 level FTT will work easily or well.

2. The structure of a FAT

The consultation states that there are several policy goals that may be pursued through a FAT. There is no indication whether there is any political consensus among EU member states on these various possible policy goals, or if not, how that agreement might be achieved. The same points on relocation risk apply as for a FTT above, depending on whether it is applied at EU or G20 level. Subject to this, our comments on each of the possible forms of FAT are as follows:

<u>Addition method FAT</u> We consider this has a questionable policy basis which is as compensation for VAT exemption. This form of FAT would be highly complex and would impose considerable administration burdens on financial institutions. Smaller financial institutions would struggle to meet the additional compliance burden. Financial sector VAT exemption is actually a burden and not a benefit. The largest UK building societies incur [irrecoverable] VAT on trading costs in the order of £100 million annually.

<u>Rent taxing FAT</u> A form of FAT that applied to super profit or remuneration within the sector would be less complex to design and, arguably, more fairly targeted – it meets the principle of evidence-based taxing of undesirable behaviours. This form of FAT is likely to have the least impact on mutuals such as building societies if it were to be restricted to ordinary operating profit. If additional taxes are to be imposed, this may be preferable as a replacement for, rather than a supplement to, the UK bank levy.

<u>Risk taxing FAT</u> Again, this form of FAT appears complex and, if applied without limit across the sector, is likely to create disproportionate compliance burdens. If this form of FAT is designed to deal with excess return due to unduly risky activities, there is the risk of overlap in policy purpose with the UK bank levy and therefore the possibility of double taxation arising from effectively the same cause. It also overlaps with measures in the Capital Requirements Regulation aimed at reducing and containing various banking risks.

Other measures, including levies

The consultation states that the policy options are not limited to a FTT or a FAT and includes questions on the cumulative effects of other measures like bank levies. The general response to cumulative measures is considered in the section on under-taxation of the sector.

A form of levy at EU or G20 level which required conformity in domestically applied levies, and which was structured more fairly and proportionately than the UK bank levy, being properly related to riskier financial sector institutions, may be more acceptable to the UK mutual sector generally.

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